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*Ladies and Gentlemen!*

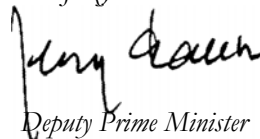
*We have the pleasure to present to You the current editions of the "Reports on the Economy", which our Ministry has prepared for a number of years. Aside from the overall description of the basic events and macroeconomic trends which apply to the whole economy, the Reports offer a detailed presentation of the most important areas (industry, foreign trade, the labor market, social policy ... ).*

*The year 2003 brought many positive changes in the economic situation of Poland. The symptoms of overcoming economic stagnation, and an increasingly pronounced revival, registered in the subsequent quarters of the previous year, have grown even stronger in the first half of this year. The financial situation of enterprises clearly improved. The signals which announce a coming revival in investment are also growing stronger. In the nearest future, we should expect even clearer signs that the positive trends influence the economy and work to improve the situation in the labor market.*

*The current economic revival is primarily the success of Polish entrepreneurs. It has been supported by the appropriate policy of the government, whose activities in the area of support for and promotion of entrepreneurship are very positively received by the entrepreneurs. The new law, dated 2<sup>nd</sup> July 2004, on the freedom of business activity, broadens the economic freedom, strengthens the position of the entrepreneur in contacts with the administration. As a result, it facilitates business activity.*

*Year 2004 is a very special period. On 1<sup>st</sup> May, Poland became a member of the European Union. This move should be seen both as a chance and a challenge. To meet the expectations, it is necessary to improve the competitiveness of Polish firms, and to base the development of economy on knowledge and innovation. In order to achieve that, we must not focus only on the current issues. Our plans must cover a longer perspective. Currently the government is working on preparing the National Development Plan for the years 2007–2013. It will cover development strategies for the individual areas of the economy. Actions undertaken under these strategies are meant to assure stable development of the Polish economy; and accelerate the process of convergence with countries of the European Union.*

Jerzy Hausner



Deputy Prime Minister  
Minister Of Economy & Labour

*Warsaw, September 2004*



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## SYNTHESIS

*COMPETITIVENESS OF THE POLISH ECONOMY.* Competitiveness of the Polish economy remains low. According to international assessments of competitive position (which take into account a variety of ratios), Polish economy is placed somewhere in the middle of over 100 countries which are subject to evaluation. It does not show any improvement. In fact, in the case of a few indices, the situation is deteriorating. The evaluation is similarly low after a comparison of the basic macroeconomic and structural indices. The per capita Gross Domestic Product (GDP), which is a measure of the country's wealth, labour productivity and of competitiveness of the economy (measured according to the purchasing power parity), amounts only to 42.7% of the average of the EU-15 ("old" member countries), and about 46% of the average for all the 25 member countries of the new, enlarged European Union.

A comparative analysis of the structural funds, suggested by the European Commission, suggests that the results achieved by Poland are worse, in most cases, than the results of the EU-15 countries, and than the results of the leaders among the new member countries of the EU. Only in a few cases, the results achieved by Poland are better than the worst result among the EU-15 countries. Greece is worse in terms of the human resources expenditures, research and development, information technology, Belgium – from the perspective of employment rate of older citizens, Ireland has a higher poverty risk ratio and Italy exhibits larger regional differences in the employment rate. Poland's performance is very poor in the areas of employment and prolonged unemployment.

*ECONOMIC GROWTH.* In 2003, Poland exhibited a more solid economic growth, and quarterly growth indicators showed a rising trend. The main source of economic growth in Poland remains the rising productivity of production means, given a decrease in the number of employed in the economy and a relatively low rate of gross investment. An important reason for the growth of productivity are significant changes in the quality of the existing capital and in the labour culture and organization.

After a slowdown of the economic growth, Poland's economy has shown symptoms of a revival since the second half of 2002. In 2003, a progressive increase of the growth rate was observed. In the first quarter, as compared to the same period of the previous year, GDP increased by 2.3%, in the second quarter by 3.9%, in the third by 4.0% and in the fourth quarter, the growth reached 4.7%. As a result, in 2003 the growth of the Gross Domestic Product amounted to 3.8% (as compared to 1.0% in 2001 and to 1.4% in 2002).

The sector of market services is playing an increasingly positive role in the economic growth. Meanwhile, the role of industry and construction varies and is positive or negative, depending on the current phase of the cycle and external factors. In 2003, the value added in the economy rose by 3.6% (as compared to 1.3% in 2002). This was caused mainly by its very high increase in industry (7.6%), and a stable growth in the services sector (4.1%). In the latter sector, the gross value added accounted for over 50% of the total value. Reverse tendencies were observed in the construction sector. A difficult situation of that sector translated into a decline in the gross value added.

The factors, which influenced the economic growth on the demand side, included the consumer demand and net export. The domestic demand increased by 2.4%, as compared to the previous year. Total consumption rose by 2.5%, while private consumption in 2003 was by 3.1% higher than in 2002.

A growth of the average monthly salary reached 4.9% in 2003 (4.1% in terms of effective value). The average effective retirement pension and disability pension from the system of social insurance for non-farmers was higher by 4.1% than in 2002, while the average effective retirement pension and disability pension for farmers rose by 2.8%, compared to the value last year. At the same time, in 2003 a decline was observed in the value of savings deposits and securities with maturity up to 2 years held by households (by 7.5%); and an increase in the value of credits contracted by families, by 13.6%. Thus, it can be said that private consumption was financed mainly at the cost of decreasing savings of households, which in turn proves that families are optimistic with respect to their future revenues.

The main factor, which positively influenced the dynamics of GDP in 2003, was the net export. This tendency has been in place since 2000. The positive influence of net export is also closely tied to a negative influence of the gross accumulation. The reason for this situation is a low level of domestic savings.

In 2003, gross accumulation rose by 1.8%, as compared to 2002. Gross outlays in fixed assets, despite an increase in the third quarter and expectations for maintenance of that trend in the following quarter, fell by 0.9% in the whole 2003. Therefore, it can be stated that the growth of gross accumulation was caused primarily by an increase in stock inventories.

**INVESTMENT.** Despite a decline in the value of gross outlays in fixed assets in 2003, and a slight decrease of total assets, it can be stated that in the last year the negative trends in the investment activity of enterprises were overcome.

Investment outlays dropped continually from early 2001 to mid-2003. In the second half of 2003, the first symptoms of investment revival were observed. As a result, the value of investment outlays in the economy was slightly higher in the whole 2003 than in the previous year.

The symptoms of a revival in the investment demand in 2003 were concentrated in the enterprise sector, especially in the area of production activity. In other sections of industry the revival of the investment demand was delayed, which could be explained by a still poor economic situation in the global economy and a growth of uncertainty in Poland, tied to the status of public finances and plans for their improvement. A decline in outlays is still registered in construction, transport, warehousing and communication; as well as in the commerce and repairs section. A lower level of outlays was recorded also in the mining and quarrying sector.

In 2003, a decline in the inflow of foreign direct investment was overcome. According to the data published by the Polish Information and Foreign Investment Agency (PAIIZ), Poland received USD 6.42 billion. The main stream of investment came from Europe and the USA. The largest volume of FDI came from countries of the EU-15. The list of largest investor countries, from the standpoint of the cumulative value of FDI coming into Poland, did not undergo any major changes, compared to the status at the end of 2002. The largest amounts were invested by firms from France, the Netherlands and the USA. Investment is most frequently placed in the sectors of production activity and financial services. At the end of 2003, the cumulative value of FDI in Poland reached USD 72.7 billion.

**INDUSTRY.** The years 2001–2002 were characterized by a low increase in the sold industrial output. In 2003, the sold industrial output rose by 8.4%, according to preliminary data.

Enterprises with more than 9 employees increased their sold output by 8.7% compared to the previous year. The growth in the sold industrial output in 2003 was due mainly to a higher level of sales in the production activity. In this section, production rose in almost all types of enterprises. This should be particularly stressed, because the last two years saw mainly an increase in the production of consumer goods. In 2003, manufacturers of consumer goods registered a 6% increase in their sales, while entities producing primarily investment goods increased their sales by 21%. In the area of intermediate goods, the increase amounted to 11%.

A high increase was seen in the production of those sections and groups of industry which are believed to be the main vehicles of technological progress.

An increase in the production activity and in the sections which are the main vehicles of technological progress is due primarily to the pro-export nature of that production. The highest increase was recorded in the production of trucks, trailers and semi-trailers (by 30.7%). Production increased significantly also in the sectors of: production of machinery and electrical equipment, production of furniture and other activity, production of rubber and plastic goods, production of machinery and equipment, metal goods, chemical goods.

At the same time many areas of industry which are important for the economy did not feel an improvement in their situation. In 2003, the largest reduction in production was seen in the following sections: production of leather and leather goods, of other transport equipment, of clothing and furriery.

**CONSTRUCTION.** Poor economic situation, noted in the construction sector for over two years, was not overcome in 2003. In the past year, the construction and assembly production fell by 3.4%, compared to the previous year. The worse economic situation was felt more by entities with more than 9 workers, whose production fell by 5.9%.

It appears that preliminary results in housing construction do not confirm the weak economic situation in the overall construction. In 2003, the

number of completed housing units reached 162.6 thousand, which is by 66.6% more than a year before. This number is, to a large extent, caused by the statistical effect – the results in the construction sector are related to 2002, when a decline in the number of completed housing units reached 7.9%. They are also due to amendments to the Construction Law<sup>1</sup>.

**AGRICULTURE.** The beginning of 2003 was characterized by negative conditions in the winter, a delayed spring and unfavourable agro-meteorological conditions. This caused losses in the area of the winter crops. According to estimates, the total volume of agricultural production is lower for the second subsequent year, due to a decline in plant production which was not compensated with an increase in animal production. In 2003, as a result of smaller area of the crops and losses of winter crops, production of grains was lower than a year earlier. The harvest of rapeseed and oil-yielding rape, potatoes and sugar beets were also smaller. The harvest was larger in the case of vegetables and fruit, both berries and tree-grown.

The situation in the agricultural market in 2003 was determined by a high supply of animal products. As a result, the changes in prices (both in purchasing and in the marketplace) were small, and their scope was usually lower than a year earlier. The lower purchase volume of grains caused a clear increase in their prices.

As a result, the percentage ratio of the average prices of agricultural products sold by individual farmers to the prices of goods and services purchased by these farmers remained lower than 100 in 2003.

**DOMESTIC TRADE.** According to estimates of the Central Statistical Office, in 2003 the volume of retail sales of enterprises with more than 9 employees was higher by 4% from last year's results.<sup>2</sup>

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<sup>1</sup> The increases are largely of statistical nature. The amendment to the construction law introduced more stringent penalties for the use of houses without permits and caused many private investors to comply with formal requirements and to register houses, which had been inhabited for years. This was particularly visible in July.

<sup>2</sup> Fixed prices, sales calculated in current prices rose by over 7.9%.

A higher level of sales than in 2002 was seen in almost all groups. The largest increase in sales volume was registered in the specialist and non-specialist stores offering food, alcohol and soft beverages. Turnover rose also in the categories of automotive vehicles, motorbikes and parts; solid, liquid and gas fuels. The sales of other enterprises – trading in jewellery and similar goods, works of contemporary art, sports articles and games, office equipment and computers, flowers and seeds – dropped, as compared to 2002.

Wholesale sales in commercial enterprises<sup>3</sup> were higher by 3.6% (in current prices) than a year earlier.

**TOURISM.** In 2003, Poland's borders were crossed by 52.1 million foreigners (an increase by 2.7% as compared to the previous year). Of this number, 13.7 million were tourists (decrease by 1.9%). An increase was recorded in the number of one-day visitors. The largest increase of crossings was recorded on the Slovakia border (by 36%), and a decline – caused by the introduction of visas in October 2003 – on the eastern border of Poland (by more than 10%). The drop in the number of tourists is mainly a result of a worse economic situation in Germany, which is Poland's main tourism partner; and lack of security caused by numerous acts of terror. Foreign currency revenues amounted to USD 4.1 billion (a decline by 9.4%).

Poles aged 15+ went on 48.4 million domestic trips (a decline by 10.7%) and 7.2 million of foreign tourist travels (a decline by 14.3%). Poles are less willing to travel, mainly due to a difficult situation in the labour market and a reduction of social benefits. Revenues on domestic tourism amounted to USD 21.7 billion (a decline of 4.4%).

The reduced revenues on tourism, in a situation of strong GDP growth, caused the share of this area of economy to drop, from 4.6% to 4.0%.

**FOREIGN TRADE.** In 2003, the situation in foreign trade improved. A significant increase in turnover was recorded, especially in export. The trend to balance the turnover has grown stronger. Positive tendencies were seen also in the structure of the turnover. The share of raw materials and semi-finished goods fell,

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<sup>3</sup> Applies to enterprises employing more than 9 workers.



while the share of processed goods increased. The reasons for positive changes in foreign trade should be sought primarily in restructuring of Polish enterprises, made in years when the economy was slower. This restructuring was helped by a positive influence of short-term factors tied to foreign exchange rates.

In 2003, the value of exported commodities reached USD 53.6 billion, and was higher by USD 12.6 billion or by 30.6% than in the previous year. The growth rate of import during that period (from USD 55.1 billion in 2002 to USD 68 billion in 2003) was lower by 7 percentage points; but its growth in absolute terms was higher by over USD 0.3 billion. This caused an increase in the turnover deficit, from USD 14.1 billion to USD 14.4 billion. The dynamics of the turnover growth, measured in EUR, was definitely lower during the period under discussion than its value in USD.

Aside from a significant growth in the volume of turnover, 2003 brought also further improvement of the quality of Polish export. This was expressed in a more modern offer of goods and its improved competitiveness. These positive trends reflect progress in restructuring of the economy, achieved under conditions of significant involvement of foreign capital.

Modernization and improved competitiveness of Polish export offer finds its real confirmation in the changes of export's geographical structure. The share of highly developed markets (i.e. whose quality requirements are relatively high) in Polish export rose in recent years by about 5 percentage points. In 2003 it reached almost 75%. The share of the EU markets rose by 11 points, to the level of 69%. In the last year the share of the EU markets in the Polish export did not increase. The very fact of stabilization of that share, in a period of very rapid growth of export – especially in 2003 – should be considered as a significant success.

**BALANCE OF PAYMENTS.** In 2003, the negative current balance of commodities exchange reached EUR 3,514 million. This accounted for 1.9% of the GDP, compared to 3.5% in 2002 and 3.8% in 2001. The result was determined by a deficit in turnover of commodities and services. The non-classified current turnover, resulting from purchase of foreign currencies in branches of the National Bank of Poland, also played a significant role.

In 2003, similarly as in 2002, a positive balance was recorded in the capital and financial account, amounting to EUR 5,788 million. This balance was lower than in the previous year. The current accounts deficit was financed primarily by direct investment (balance in the account of direct investments constituted about 55% of the financial account balance). The balance in the account of portfolio investments amounted to 38% of the balance in the financial account. Balances of both these accounts have shown growth. In 2003, as compared to 2002, a negative change of proportions between the share of balances of direct and portfolio investments in the overall financial balance can be observed. This situation is caused by growing needs of the State Treasury for loan, which leads to a growing supply of the Treasury securities. On the other hand, the growing public debt is a factor which causes anxiety among long-term investors, which in turn causes a decline in the inflow of direct investment. It should also be noted that the balance of other investments had a significant influence on the financial result – both in the previous year and in 2003. In 2003, as compared to 2002, both a decline of Polish receivables from foreign countries, and an increase in Polish liabilities to foreign countries was observed. This may be a result of depreciation of PLN (in the previous year, the largest decrease was seen in the category of cash, current accounts and deposits). In the case of Polish liabilities for foreign countries, almost all categories are characterized by a balance higher than in the previous year.

**PRICES.** In 2003, the average annual growth of the Consumer Price Index reached 0.8%.

In the group of prices of consumer goods and services, the highest dynamics in the course of the year was found among the prices of transport and fuels, as well as the fees tied to housing and energy carriers. Analysis of the inflation index confirms that the controlled prices (prices of energy carriers and fuels) rose quicker than the prices of consumer goods and services.

The prices of sold industrial output saw a 2.6% average increase, compared to the previous year. The fastest growth was seen in the section of electricity, gas and water supply. The prices of construction and assembly production dropped by 1.1%.

**THE LABOUR MARKET.** In the last five years, the situation in the labour market became clearly worse – the employment rate dropped significantly and

the unemployment level increased. The reasons for basic problems of the Polish labour market are of structural nature. Their underlying reason is the deactivation policy of the labour market, implemented in the 1990's.

The unemployment rate, which has grown since 1998, is one of the largest problems of the Polish economy. According to data of the BAEL<sup>4</sup> research, the unemployment rate reached 19.3% at the end of the fourth quarter of 2003. This means that it was lower by 0.4 percentage point from the rate registered in the fourth quarter of 2002. The professional activity ratio in the fourth quarter of 2003 reached the level of 54.8% (it was lower by 0.2 percentage point than during the previous year).

The main factors which determine the situation on the labour market include:

- insufficient scope of the economic growth,
- still relatively high labour costs tied to a high tax wedge,
- increased labour productivity and negative trends in employment,
- a growing number of persons in productive age, caused by the market presence of persons born in the years of demographic high,
- acute price competition and weak financial standing of the enterprise sector,
- progressive globalization of the economy, which is reflected in mergers of companies to achieve economies of scale,
- mismatched supply and demand in the labour market (low qualifications and skills levels of the unemployed, low professional mobility),
- implementation of restructuring programmes (coal mining, steel sector).

The average employment in the enterprise sector in 2003 amounted to 4,724 thousand persons. This was a 3.8% reduction, compared to the same period of 2002.

Among the sections of production activity, the largest reductions of employment occurred in entities producing tobacco goods; radio, television and telecommunication equipment and devices; clothing and furriery goods. An increase in employment was found in entities producing vehicles, trailers and semi-trailers,

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<sup>4</sup> Research of the economic activity of the population.

machinery and electrical equipment, metal goods, rubber and plastic goods, furniture. These sections produce mainly for export.

In 2003, the rate of registered unemployment remained on a high level, amounting to 20% at the end of December<sup>5</sup>. The number of registered unemployed persons amounted to 3,175.7 thousand. 84.9% of all registered unemployed persons did not have the right to any benefit entitlement (83.3% a year earlier).

**PUBLIC FINANCES.** Both the public finance deficit and the public debt have risen systematically in recent years. In 2003, the volume of the budget deficit amounted to 4.5% of the Gross Domestic Product, while public debt, according to preliminary calculations, reached the level of 51.6% of the GDP. Both the budget deficit and public debt levels are too high. Also, since 2001 both these values have increased.

Budget deficit in 2003 was lower than planned in the budget law, by PLN 1.75 billion. The actual amount of expenses constituted 97.3% of budget assumptions, while the level of revenues reached 97.7% of the level as provided in the law. Lower revenues resulted primarily from lower revenues on personal income taxes, and other revenues. On the expense side, it is worth noting that the expenses for servicing public debt were much smaller than planned (31.1%).

Financing from domestic sources was lower by 7.3% than planned under the budget law, while financing from foreign sources was higher by 16.9%. The fact that debt was serviced primarily with issues of Treasury bills can be seen as a negative factor. That situation results in the shorter duration of debt, which causes an increased refinancing risk.

**MONETARY POLICY.** The first half of 2003 was a period of less stringent monetary policy. During that time, interest rates have been cut five times. However, since 26 June the Monetary Policy Council did not make any changes.

Analyzing the possible changes in monetary policy, we should take into consideration several main factors. They include the start of the long-awaited economic revival (which is not supported with a growing level of investment); the

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<sup>5</sup> As a result of the National Census and the Agrarian Census, significant differences were found in the numbers of persons employed in the agriculture sector, compared to data from the Agrarian Census of 1996, which had been used to calculate the rate of registered unemployment. This difference amounted to 1,756 thousand.

low and stable level of inflation; unsatisfactory situation in public finances, weakening PLN and the prices of raw materials in global markets.

The year 2003 was the last year of the Medium-Term Monetary Policy Strategy for 1999–2003. According to that strategy the goal of the monetary policy in 1999–2003 was to keep the level of inflation not higher than 4% at the end of 2003. This year, the goal will be to keep inflation at the level of 2.5% +/- 1 percentage point, at the end of the year.

**FOREIGN EXCHANGE RATE.** In 2003, the exchange rate of the Polish currency weakened significantly in relation to the euro. At the same time, as euro has grown stronger in relation to the US dollar in the international financial market, this caused a slight strengthening of PLN against USD.

The situation in the foreign currency market was shaped by both external and internal factors.

Among the external reasons, one of the most important ones was the uncertainty in the United States, tied to the situation in Iraq. The China trade surplus in relations with the USA is also important. Diversification of foreign currency reserves, made by China, exerts permanent pressure on appreciation of EUR. Other important economic reasons include the double deficit, still present in the USA (the so-called twin deficit: budget and current accounts), as well as low interest rates, maintained by the European Central Bank.

**THE OWNERSHIP STRUCTURE OF THE ECONOMY.** The current status of the Polish economy is an outcome of policy implemented until 1989, as well as measures taken in recent years. At the moment when the economic transformation commenced, the major part of Polish enterprises was owned by the State Treasury. An increase of the role of the private sector in the 1990's occurred both as a result of fast development of the sector of small and medium-sized enterprises, which were established with private capital and privatization of state-owned enterprises.

As a result, the number of new business entities increased almost three-fold during the transformation period. In 2003, Poland had 3.2% more enterprises than a year earlier. The number of state-owned enterprises was decreasing, primarily due to the process of privatization. The number of co-operatives was

also reduced. The number of commercial companies and businesses owned by individuals was growing. The group of commercial companies is dominated by companies with a majority of private capital. Domestic private entrepreneurs usually manage business activity as limited liability company. This form is the dominant one also among commercial companies with foreign capital rose.

The largest group of enterprises are the smallest ones, with up to 9 workers. These firms constitute as much as 95% of the total number of firms. The share of small firms (10 to 49 employees) amounts to 3.8%, and medium-sized ones (with 50 to 249 workers) to 0.8%. Large companies (with more than 250 employees) constitute 0.2% of all enterprises.

In 1990–2003, ownership transformation process covered 7,055 of the state owned enterprises. Of that total number, 1,541 were commercialized (1,527 transformed into single-owner companies of the State Treasury and 14 into companies with the participation of creditors), 2,035 were privatized directly, 1,825 were liquidated for economic reasons and 1,654 of former state farms passed into the stock of the State Agency of Agricultural Property.

***FINANCIAL RESULTS OF ENTERPRISES.*** In 2003 the financial situation of enterprises improved. Revenues were rising faster than costs, which led to an improvement of the financial result.

Revenues on the overall activity rose by 12.0% – 2.9 percentage points more than the costs. Financial results improved. The result on sale of products and materials amounted to PLN 51.3 billion (an increase of 49.5%), and the gross financial result rose by almost five times, reaching the volume of PLN 41.0 billion. The net financial result, which a year ago was negative (PLN 2.2 billion), in 2003 was positive and amounted to PLN 27.2 billion. The following indices rose: sales profitability (from 3.1% to 4.2%), gross turnover profitability (from 0.7% to 3.2%), and the ratio of net turnover profitability (from –0.2% to 2.1%). Debt rose by about 1.8%, to the total level of PLN 492.5 billion. The debt growth rate was lower than the growth rate of revenues – for the first time in several years. Financial liquidity also improved. Only the ratio of 3<sup>rd</sup> degree liquidity was below the values considered to be safe. The increase in results, financial and economic indices resulted on one hand from improved effectiveness of management, and on the other, from the debt reduction of the hard coal mining sector. The govern-

ment cancelled the sector's liabilities amounting to a total of PLN 18.1 billion. Of that, PLN 13.2 billion constituted balance sheet liabilities. The cancelled balance sheet liabilities increased the revenues on other operating activity and financial revenues (without the cost side counterparts). This resulted in: higher revenues on overall activity, higher gross financial result and growth of the net financial result by an amount equivalent to the cancelled liabilities.

***POLAND'S INTEGRATION WITH THE EU.*** For Poland, the process of European integration commenced in 1991, with the signing of the European Treaty establishing association between the Republic of Poland and the European Community and its Member States. At that time, the basic directions of adjustment actions have been set. On 16 April 2003 the Accession Treaty was signed by 15 current Member States of the European Union, and ten newly joining members. At the same time, increasing the dynamics of meeting the EU requirements became a priority. On 2 July 2003 the Council of Ministers adopted the Programme for Poland's Preparation to Membership in the European Union, which covered all legislative and non-legislative tasks (regarding primarily institutions) that had to be completed before 1 May 2004.

One of the most important tasks was to develop a flexible mechanism that would merge domestic funds with the resources received from the structural funds and the Cohesion Fund into a single system, complying with the rules of the European Union. The law on the National Development Plan of 20 April 2004, constitutes the fulfilment of this goal. The plan is a basis for Poland to negotiate the Community Support Framework (a document which determines the directions and amounts of assistance from the structural funds). This document defines the most important structural activities that Poland would start upon becoming member of the EU. The law on the National Development Plan states that NDP provisions must be taken into account while drawing up the state budget, draft budgets of the local governments, annual plans of target funds and annual financial plans of other units and entities of the public finance sector during subsequent years of the Plan.

On 1 May 2004 Poland became a full-fledged member of the European Union. This means both benefits that Poland can achieve, and costs, which have to be borne.

According to analyses, and on the basis of experience of countries, which joined the EU during earlier phases of enlargement (Ireland, Spain, Portugal), we expect a faster rate of economic development (measured with the GDP growth rate). During the membership years, in all these countries tendency for the so-called effective convergence appeared – the level of GDP per capita came closer to the EU-15 average. Effective convergence caused a faster GDP growth rate, which meant a reduction - and in the case of Ireland, full elimination – of the differences in GDP levels, compared to other countries of the EU. In the case of Poland, it is expected that the growth of GDP will be by 0.8–1.2 percentage point higher owing to accession.

Another benefit is an increase in investment outlays, which in the short, or perhaps even medium term do not cause a direct increase in production or consumption. The results in the form of faster production growth rate, changes in quality or growth in competitiveness, caused by the application of new technologies, are usually delayed.

The growth of investment outlays after accession to the EU will be possible primarily thanks to the inflow of assistance funds from the European Union and the increased – as can be expected – scope of foreign direct investment and more intense international exchange (flow of goods and capital).

At the same time, the costs of Poland's accession to the European Union have to be mentioned. The sums paid by Poland to the EU budget as membership contributions can be seen as cost of that membership. At the same time, we expect an increased inflow from the assistance funds, allocated for Poland.

An increase in bureaucracy (and the related costs) can also be seen as another cost of accession to the EU, as it is tied to the need of introducing many procedures required under the EU regulations.

We can also expect an increased emigration of highly qualified specialists to countries of the EU (*brain drain*). However, this process can be counter-balanced, as Poles will have opportunities for migration and looking for job abroad.

We should also mention the adaptation costs, resulting from acceleration of structural changes in the economy, tied to accession to the EU. Structural changes mean a reduction of the scope, or cessation of production in some areas (or some large enterprises), as well as bankruptcies of enterprises. The consequence will be loss of jobs by large socio-economic groups, and social



tensions. The above discussed events are unavoidable in the longer time perspective – regardless of whether Poland is a member of the EU, or not. A delay of structural changes worsens Poland's economic situation and limits the opportunities for achieving a high rate of the socio-economic development. In this context, we can say that accession to the EU accelerates and facilitates the processes of changes, which were necessary, anyway.

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**CHALLENGES.** In 1990–2003, fundamental changes occurred in the Polish economy. Transformation of the system, which Poland commenced in the early 1990's, meant a radical political breakthrough and fundamental changes in the economic and social systems. The inclusion in the Western structures and economic institutions was seen as the most effective way to catch up with the development and technological gaps and as one of the most important factors for sustainable economic growth. One of the basic aspects of the transformation was a change of the current laws, and their adjustment to the mechanisms used in a free market economy. As a result of appropriate legal changes, the remnants of central planning have been liquidated. A package of macroeconomic solutions was introduced, which stabilized the economy together with protection of private property. Internal prices – wholesale and retail – were liberated. The state control of foreign trade was removed, internal convertibility of PLN introduced together with uniform foreign exchange rate<sup>6</sup>. Financial turnover with foreign countries was liberalised. Conditions for internal competition were created with the policy of full freedom of business activity and establishment of new enterprises. At the beginning of the 1990's, the process of economic transformation commenced and is continued.

The reforms of the 1990's constitute the basis for the functioning of the economy in its current form. Despite these significant changes, there are still many tasks, which must be executed. The next initiatives are meant to promote rapid convergence of the Polish economy with countries of the EU-15.

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<sup>6</sup> EUR/PLN exchange rates: 1999 – EUR 1 = PLN 4.2270, 2000 – 1 EUR = 4.0110 PLN, 2001 – 1 EUR = PLN 3.6685, 2002 – EUR 1 = PLN 3.8557, 2003 – EUR 1 = PLN 4.3978.

The purpose of the structural reforms, which are implemented in many areas, is to create an open economy that would be knowledge based and characterized by high level of innovation and competitiveness.

The challenges that Poland will face in the nearest future include:

- Acceleration and then maintenance of a stable rate of the economic growth – in particular, through development of the sector of small and medium-sized enterprises. This is meant also to increase the level of employment.
- Promotion of entrepreneurship, through facilitating the companies' access to capital; as well as reduction of red tape in administrative proceedings and provision of transparency and stability of regulations for this sector.
- Effective and durable reduction of the deficit in public finance sector, with the view of its permanent elimination. Restructuring of public expenses in all areas of life.
- Further restructuring and privatization of the economy, reduction of the volume of public assistance to a minimum, but at the same time guaranteeing competitiveness in areas which remain under control of the public sector.
- Increasing openness of the Polish economy and its competitiveness in global markets. This can be supported by higher innovation of Polish products, and also by higher qualifications of employees, achieved through promotion of lifelong learning.
- Providing full freedom for the flow of goods, services, capital and human resources, in the context of European integration.
- Creating conditions for utilizing the benefits tied to membership in the European Union, increasing the level of absorption of structural funds.

Table 1. Basic indicators of the economic situation in 1995–2003 (dynamics, previous year = 100)

| No   | Description  | Unit of measure | 1995     | 1996     | 1997     | 1998     | 1999     | 2000     | 2001     | 2002     | 2003     |
|------|--|-----------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| 1.   | Gross Domestic Product (fixed prices)                                | PLN billion     | 308.1    | 387.8    | 472.3    | 553.6    | 615.1    | 713.4    | 750.8    | 780.4    | 815.0    |
| 2.   | Gross Domestic Product (fixed prices)                                | %               | 107.0    | 106.0    | 106.8    | 104.8    | 104.1    | 104.0    | 101.0    | 101.4    | 103.8    |
| 3.   | Domestic demand (fixed prices)                                       | %               | 107.0    | 109.7    | 109.2    | 106.4    | 104.8    | 102.8    | 98.3     | 100.9    | 102.4    |
| 3.1  | - private consumption financed with personal revenues (fixed prices) | %               | 103.2    | 108.7    | 106.9    | 104.8    | 105.2    | 102.8    | 102.1    | 103.3    | 103.1    |
| 3.2  | - gross outlays on fixed assets (fixed prices)                       | %               | 116.5    | 119.7    | 121.7    | 114.2    | 106.8    | 102.7    | 91.2     | 94.2     | 99.1     |
| 4.   | Sold industrial output <sup>1)</sup>                                 | %               | 109.7    | 108.3    | 111.5    | 103.5    | 103.6    | 106.7    | 100.6    | 101.4    | 108.4    |
| 5.   | Prices of sold industrial output (annual average)                    | %               | 125.4    | 112.4    | 112.2    | 107.3    | 105.7    | 107.8    | 101.6    | 101.0    | 102.6    |
| 6.   | Consumer Price Index (annual average)                                | %               | 127.8    | 119.9    | 114.9    | 111.8    | 107.3    | 110.1    | 105.5    | 101.9    | 100.8    |
| 6.1  | Consumer Price Index (December / December)                           | %               | 121.6    | 118.5    | 113.2    | 108.6    | 109.8    | 108.5    | 103.6    | 100.8    | 101.7    |
| 7.   | Construction and assembly production (fixed prices)                  | %               | 108.1    | 104.6    | 117.1    | 111.0    | 109.4    | 101.4    | 88.3     | 91.3     | 96.0     |
| 8.   | Completed housing units  | thousand        | 67.1     | 62.1     | 73.7     | 80.6     | 82.0     | 87.7     | 105.9    | 97.6     | 166.7    |
| 9.   | Total investment outlays (fixed prices)                              | %               | 117.1    | 119.2    | 122.2    | 115.3    | 105.9    | 101.4    | 90.5     | 90.0     | 99.3     |
| 10.  | Gross turnover profitability ratio <sup>2)</sup>                     | %               | 4.2      | 3.4      | 3.6      | 2.0      | 1.1      | 1.9      | 0.7      | 0.8      | 2.8      |
| 10.1 | - of this, industry  | %               | 4.9      | 3.6      | 3.7      | 1.7      | 0.7      | 1.4      | 0.6      | 1.2      | 3.8      |
| 11.  | Net turnover profitability ratio <sup>2)</sup>                       | %               | 2.0      | 1.6      | 1.8      | 0.6      | -0.2     | 0.7      | -0.3     | -0.2     | 1.7      |
| 11.1 | - of this, industry  | %               | 2.3      | 1.6      | 1.9      | 0.4      | -0.6     | 0.3      | -0.3     | 0.2      | 2.5      |
| 12.  | Export of commodities (customs data)                                 | USD million     | 22,894.9 | 24,439.8 | 25,751.3 | 28,228.9 | 27,407.4 | 31,651.3 | 36,092.2 | 41,009.8 | 53,576.9 |

<sup>1)</sup> Ratio of production volume and of the prices of sold industrial output from 1996 onwards have been calculated according to base prices in the previous years, on the basis of producer prices.

<sup>2)</sup> The gross turnover profitability ratio in the economy and in industry apply to entities with more than 50 workers in the mining and quarrying sector, and production activity; and more than 20 persons in the remaining sections (by the end of 1998). Data for the years 1999–2000 applies to enterprises with more than 49 workers in all sections of the economy.

| No   | Description  | Unit of measure  | 1995     | 1996      | 1997      | 1998      | 1999      | 2000      | 2001      | 2002      | 2003                  |
|------|--|------------------|----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------------------|
| 12.1 | Dynamics (previous year = 100)   | %                | 132.8    | 106.7     | 105.4     | 109.6     | 97.1      | 115.5     | 114.0     | 113.6     | 130.6                 |
| 13.  | Import of commodities (customs statistics)   | USD million      | 29,049.7 | 37,136.7  | 42,307.5  | 47,053.6  | 45,911.2  | 48,940.2  | 50,275.1  | 55,112.7  | 68,003.9              |
| 13.1 | Dynamics (previous year = 100)   | %                | 134.7    | 127.8     | 113.9     | 111.2     | 97.6      | 106.6     | 102.7     | 109.6     | 123.4                 |
| 14.  | Balance of commodities exchange  | USD million      | -6,154.8 | -12,696.9 | -16,556.2 | -18,824.7 | -18,503.8 | -17,288.9 | -14,182.9 | -14,102.9 | -14,427.0             |
| 15.  | Employment in the national economy – annual average                                    | thousand persons | 14.735   | 15.021    | 15.439    | 15.800    | 15.373    | 15.018    | 14.924    | 14.784    | 14.4871)              |
| 15.1 | Dynamics (previous year = 100)   | %                | 101.8    | 101.9     | 102.8     | 102.3     | 97.3      | 97.7      | 99.4      | 99.1      | 98.0                  |
| 16.  | Average employment in the economy  | thousand persons | 9,360.0  | 9,479.8   | 9,751.5   | 9,863.8   | 9,637.1   | 9,354.1   | 9,050.2   | 8,915.7   | 8,672.6 <sup>1)</sup> |
| 16.1 | Dynamics (previous year = 100)   | thousand persons | 102.8    | 101.3     | 102.9     | 101.2     | 97.7      | 97.1      | 96.7      | 98.5      | 97.3                  |
| 17.  | Employment (end of period)   | thousand persons | 2,628.8  | 2,359.5   | 1,826.4   | 1,831.4   | 2,349.8   | 2,702.6   | 3,115.1   | 3,217.0   | 3,175.7               |
| 17.1 | Dynamics (previous year = 100)   | %                | 92.6     | 89.8      | 77.4      | 100.3     | 128.3     | 115.0     | 115.3     | 103.3     | 98.7                  |
| 18.  | Unemployment rate (end of year)  | %                | 14.9     | 13.2      | 10.3      | 10.4      | 13.1      | 15.0      | 19.4      | 20.0      | 20.0                  |
| 19.  | Average nominal gross monthly salary in the national economy                           | PLN              | 690.9    | 874.3     | 1,065.8   | 1,232.7   | 1,697.1   | 1,893.7   | 2,045.1   | 2,097.8   | 2,201.5               |
| 19.1 | - in the enterprise sector   | PLN              | 754.2    | 956.9     | 1,162.1   | 1,348.6   | 1,834.8   | 2,056.8   | 2,203.1   | 2,277.4   | 2,341.5               |
| 20.  | Average effective gross monthly salary in the national economy                         | %                | 102.8    | 105.5     | 105.9     | 103.3     | 104.7     | 101.0     | 102.5     | 100.7     | 104.1                 |
| 20.1 | - in the enterprise sector   | %                | 103.2    | 105.8     | 105.5     | 103.7     | 103.0     | 101.3     | 101.6     | 101.5     | 102.0                 |
| 21.  | Dynamics of labour effectiveness, measured as GDP per 1 employee (previous year = 100) | %                | 104.8    | 103.3     | 103.5     | 102.3     | 106.9     | 106.1     | 101.7     | 103.6     | 104.3                 |
| 22.  | State budget balance   | PLN million      | -7,448   | -9,167    | -5,903    | -13,193   | -12,479   | -15,391   | -32,358   | -39,403   | -36,517               |
| 22.1 | - as percentage of GDP   | %                | -2.4     | -2.4      | -1.2      | -2.4      | -2.0      | -2.2      | -4.3      | -5.1      | -4.5                  |
| 23.  | Current account balance  | PLN million      | 854      | -3,264    | -5,744    | -6,901    | -12,487   | -9,980    | -5,372    | -5,007    | -4,085                |
| 23.1 | - as percentage of GDP   | %                | 0.7      | -2.3      | -4.0      | -4.4      | -8.1      | -6.1      | -2.9      | -2.7      | -1.9                  |

<sup>1)</sup> The data takes into account employees in individual farms, on the basis of data of the Agrarian Census of 1996.

Source: Data of the CSO and NBP; and calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour.

## Chapter 1

# COMPETITIVENESS OF THE POLISH ECONOMY

Competitiveness of the economy is the ability to generate, as a result of exposure to international competition, relatively high revenues on production factor; and ability to guarantee high employment level based on durable foundations<sup>7</sup>.

### 1.1. International rankings of competitiveness

Competitiveness of Polish economy remains low. According to international assessments of competitive position (which take into account a variety of ratios), the Polish economy is placed somewhere in the middle of over 100 countries, which are subject to evaluation. It does not show any improvement. In fact, in the case of a few indices, the situation is deteriorating. The evaluation is similarly low in the case of comparison of basic international macroeconomic and structural indices. The per capita Gross Domestic Product (GDP), which is an approximate measure of country's wealth, labour productivity and competitiveness of economy (measured as per the purchasing power parity), amounts only to 42.7% of the EU-15 average.

#### Box 1 Global rankings of competitiveness

Competitiveness ratio of the International Institute for Management Development (IMD) takes into account: the economic results (the domestic economy, international trade, foreign investment, employment and level of prices); effectiveness of the government activities (public finances, fiscal policy, quality of legislation, institutional Boxwork and social conditions); effectiveness of enterprises (productivity, labour market, finances, management) and infrastructure (transport, technological, scientific, as well as health, environment and education).

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<sup>7</sup> Globalization and Competitiveness Relevant Indicators, STI Working Paper, No 16.

The Business Competitiveness Index (BCI) of the World Economic Forum evaluates global economies from the standpoint of a possibility of effective operations of companies. It assesses the terms under which domestic or foreign companies compete in the market of a given country; and the quality of the business environment in which companies operate.

The Growth Competitiveness Index (GCI) of the World Economic Forum measures the mid-term perspectives for the economic growth. It takes into account macroeconomic conditions of a given country, quality of public institutions and technological advancement.

The Inward FDI performance index of the UNCTAD evaluates countries from the perspective of an inflow of foreign direct investment, corrected by the size of the relevant economies. This is a share of a given country in the global flow of foreign direct investment, corrected by the share of GDP of a given country in the global economy.

The Inward FDI potential index of the UNCTAD takes into account a number of factors not related to the size of economies. It evaluates countries from the perspective of their attractiveness for the foreign investors, analysing political and economic factors.

The results of the three most important reports on competitiveness place Poland between the 43<sup>rd</sup> and 55<sup>th</sup> place among all evaluated countries. Despite the fact that the criteria for evaluation are very varied, the reports allow for an attempt to define the strong and weak sides of the Polish economy from the standpoint of its competitiveness. The synthetic indices, contained in the reports, are build from a number of detailed indices, which evaluate individual social and economic factors, which influence competitiveness.

The advantages include elements, which boost the position in rankings. According to the authors of reports, the advantages of Poland include: economic growth, inflation level, costs of labour in industry, expansion of Polish products in international markets, technical advancement (in the context of competitiveness of growth), attractiveness for foreign investors (potential attraction of foreign direct investment).

The disadvantages mean factors, which weaken the competitive position. The disadvantages of the Polish economy include: business environment for the activity of enterprises, quality of public institutions, infrastructure, instability of the

public finance system, high unemployment and low employment. The tables below present the placement of Poland in the various rankings, together with selected European countries.

Table 1. Ranking according to the IMD competitiveness index

| Year | Great Britain | Germany | France | Spain | Hungary | Czech Republic | Italy | Slovakia | Poland |
|------|---------------|---------|--------|-------|---------|----------------|-------|----------|--------|
| 2003 | 19            | 20      | 23     | 27    | 34      | 35             | 41    | 46       | 55     |
| 2002 | 16            | 17      | 25     | 23    | 30      | 32             | 34    | 38       | 45     |

Source: International Institute for Management Development, *World Competitiveness Yearbook 2004*.

Table 2. Ranking according to the factors which are taken into account for the IMD competitiveness index

|   | Czech Republic | Hungary | Slovakia | Poland |
|---|----------------|---------|----------|--------|
| economic results                            | 27             | 37      | 45       | 56     |
| effectiveness of the government actions     | 34             | 35      | 44       | 55     |
| effectiveness of the entrepreneurs activity | 49             | 37      | 50       | 55     |
| infrastructure                              | 29             | 33      | 40       | 48     |

Source: International Institute for Management Development, *World Competitiveness Yearbook 2004*.

Table 3. Ranking according to the Business Competitiveness Index

| Year | Great Britain | Germany | France | Spain | Hungary | Czech Republic | Italy | Slovakia | Poland |
|------|---------------|---------|--------|-------|---------|----------------|-------|----------|--------|
| 2003 | 6             | 5       | 10     | 25    | 38      | 35             | 24    | 43       | 47     |
| 2002 | 3             | 4       | 15     | 25    | 28      | 34             | 24    | 42       | 46     |

Source: World Economic Forum, *Global Competitiveness Report 2003–2004*.

Table 4. Ranking according to factors taken into account under the business competitiveness index (BCI)

|  | Czech Republic | Hungary | Slovakia | Poland |
|--|----------------|---------|----------|--------|
| business environment for the operations of enterprises | 38             | 37      | 43       | 45     |
| market strategies                                      | 33             | 45      | 44       | 43     |

Source: World Economic Forum, *Global Competitiveness Report 2003–2004*.

Table 5. Ranking according to the Growth Competitiveness Index (GCI)

| Year | Great Britain | Germany | France | Spain | Hungary | Czech Republic | Italy | Slovakia | Poland |
|------|---------------|---------|--------|-------|---------|----------------|-------|----------|--------|
| 2003 | 15            | 13      | 26     | 23    | 33      | 39             | 41    | 43       | 45     |
| 2002 | 11            | 14      | 28     | 20    | 29      | 36             | 33    | 46       | 50     |

Source: World Economic Forum, *Global Competitiveness Report 2003–2004*.

Table 6. Ranking according to the factors taken into account under the Growth Competitiveness Index (GCI)

|                                | Czech Republic | Hungary | Slovakia | Poland |
|--------------------------------|----------------|---------|----------|--------|
| quality of public institutions | 47             | 33      | 51       | 58     |
| macroeconomic conditions       | 39             | 38      | 50       | 49     |
| technological advancement      | 21             | 32      | 33       | 34     |

Source: World Economic Forum, Global Competitiveness Report 2003–2004.

Table 7. Ranking of the inflow of foreign direct investment (inward FDI performance index)

| years     | Great Britain | Germany | France | Spain | Hungary | Czech Republic | Italy | Slovakia | Poland |
|-----------|---------------|---------|--------|-------|---------|----------------|-------|----------|--------|
| 1999–2001 | 28            | 39      | 62     | 41    | 53      | 11             | 109   | 26       | 47     |
| 1998–2000 | 24            | 47      | 76     | 60    | 53      | 15             | 115   | 41       | 42     |

Source: UNCTAD, World Investment Report 2003.

Table 8. Ranking of the potential attraction of FDI (inward FDI potential index)

| years     | Great Britain | Germany | France | Spain | Hungary | Czech Republic | Italy | Slovakia | Poland |
|-----------|---------------|---------|--------|-------|---------|----------------|-------|----------|--------|
| 1999–2001 | 4             | 6       | 14     | 25    | 41      | 37             | 26    | 48       | 43     |
| 1998–2000 | 3             | 6       | 12     | 26    | 45      | 38             | 25    | 49       | 43     |

Source: UNCTAD, World Investment Report 2003.

Table 9. Ranking according to the factors which are taken into account for the inward FDI potential index<sup>8</sup>

|                                       | Czech Republic | Hungary | Slovakia | Poland |
|---------------------------------------|----------------|---------|----------|--------|
| economic growth                       | 0.54           | 0.59    | 0.62     | 0.73   |
| number of university students         | 0.40           | 0.41    | 0.50     | 0.67   |
| volume of export                      | 0.36           | 0.38    | 0.31     | 0.13   |
| accessibility of phone lines          | 0.51           | 0.42    | 0.52     | 0.39   |
| popularity of mobile telephones       | 0.55           | 0.31    | 0.42     | 0.23   |
| expenses for research and development | 0.34           | 0.12    | 0.18     | 0.19   |
| scope of export of natural resources  | 0.02           | 0.02    | 0.02     | 0.05   |
| import of high-tech products          | 0.03           | 0.05    | 0.01     | 0.03   |
| export of services                    | 0.01           | 0.02    | 0.01     | 0.04   |

Source: UNCTAD, World Investment Report 2003.

<sup>8</sup> The highest index is 1.



## 1.2. Poland compared to the EU Member States

### 1.2.1. Gross Domestic Product

The European Union (EU-15) achieved in 2003 a growth of GDP of 0.8% (this was 0.3 percentage point less than in 2002). In comparison, the average growth rate of GDP in the European Union in 1996-2000 reached 2.7%. In 2001, it amounted to 1.7%. In 2004, the growth of GDP in these countries is expected to reach 2%; and 2.4% in 2005<sup>9</sup>.

Countries of the EU-15 develop slower than the global economy, which – according to a report of the IMF<sup>10</sup> – achieved a growth of 3.9% in 2003. In 2004 and 2005 it should grow by 4.6% and 4.4%, respectively.

Table 10. Change of GDP in countries of the EU, Poland, USA and Japan

| Country         | Change of GDP (in % compared to the previous period) |      |           |               |         |
|-----------------|--|------|-----------|---------------|---------|
|                 | 2001   | 2002 | 2003 est. | 2004 forecast | 1Q 2004 |
| Austria         | 0.8  | 1.4  | 0.7       | 1.8           |         |
| Belgium         | 0.6  | 0.7  | 1.1       | 2.0           | 0.6     |
| Finland         | 1.1  | 2.3  | 1.9       | 2.6           | 0.5     |
| France          | 2.1  | 1.2  | 0.2       | 1.7           | 0.8     |
| Greece          | 4.0  | 3.9  | 4.2       | 4.0           |         |
| Spain           | 2.8  | 2.0  | 2.4       | 2.8           |         |
| Ireland         | 6.2  | 6.9  | 1.2       | 3.7           |         |
| Luxembourg      | 1.2  | 1.3  | 1.8       | 2.4           |         |
| The Netherlands | 1.2  | 0.2  | -0.8      | 1.0           | 0.4     |
| Germany         | 0.8  | 0.2  | -0.1      | 1.5           | 0.4     |
| Portugal        | 1.7  | 0.4  | -1.3      | 0.8           |         |
| Italy           | 1.8  | 0.4  | 0.3       | 1.2           | 0.4     |
| EU-12           | 1.6  | 0.9  | 0.4       | 1.7           | 0.6     |
| Denmark         | 1.6  | 1.0  | 0.0       | 2.1           |         |
| Sweden          | 0.9  | 2.1  | 1.6       | 2.3           |         |
| Great Britain   | 2.1  | 1.6  | 2.2       | 3.0           | 0.6     |
| EU-15           | 1.7  | 1.1  | 0.8       | 2.0           | 0.6     |
| Cyprus          | 4.0  | 2.0  | 2.0       | 3.4           |         |

<sup>9</sup> Forecasts of the European Commission, Brussels, 7.04.2003.

<sup>10</sup> World Economic Outlook, IMF April 2004.

|                         |      |      |                   |     |                   |
|-------------------------|------|------|-------------------|-----|-------------------|
| Czech Republic          | 3.1  | 2.0  | 2.9               | 2.9 |                   |
| Estonia                 | 6.5  | 6.0  | 4.8               | 5.4 |                   |
| Lithuania               | 6.5  | 6.8  | 8.9               | 6.9 |                   |
| Latvia                  | 7.9  | 6.1  | 7.5               | 6.2 |                   |
| Malta                   | -1.2 | 1.7  | 0.4               | 1.4 |                   |
| POLAND                  | 1.0  | 1.4  | 3.7 <sup>11</sup> | 4.6 | 6.9 <sup>12</sup> |
| Slovakia                | 3.8  | 4.4  | 4.2               | 4.0 |                   |
| Slovenia                | 2.9  | 2.9  | 2.3               | 3.2 |                   |
| Hungary                 | 3.8  | 3.5  | 2.9               | 3.2 |                   |
| EU-10                   | 2.5  | 2.4  | 3.6               | 4.0 |                   |
| EU-25                   | 1.7  | 1.1  | 0.8               | 2.0 | 0.6               |
| Main partners of the EU |      |      |                   |     |                   |
| USA                     | 0.5  | 2.2  | 3.1               | 4.2 | 1.0               |
| Japan                   | 0.4  | -0.4 | 2.7               | 3.4 |                   |

Source: Forecasts of the European Commission, Brussels, 7.04.2004; Communiqué of Eurostat no. 48/2004 of 16.04.2004; EUROSTAT: EC Economic data pocket book 1/2004.

In 2003, the economic situation in individual countries of the EU-15 was varied. A drop in GDP was recorded by Portugal, the Netherlands and Germany. The economies of Greece and Spain developed the fastest. It is estimated that the countries of the EU-15 should achieve a 2% growth in 2004. Germany, which is Poland's main trade partner, should achieve a growth of 1.5%<sup>13</sup>.

In 2003, the growth of GDP in Poland reached 3.7%<sup>14</sup>, higher by 2.9 percentage points than the average for the EU-15 countries. Acceleration of Poland's growth rate is expected in the coming years (according to the European Commission, to 4.6% in 2004 and to 4.8% in 2005, according to the estimates of the Ministry of Economy and Labour, to 6% and 5.6%, respectively). Export was one of the main drivers of GDP growth in Poland. Its volume to the EU-15 countries rose by 25%. Export to the countries of EU-15, Poland's main commercial partner, constituted 68.8% of all Polish export in 2003. In the case of import, the proportion reached 61.1%.<sup>15</sup>

<sup>11</sup> 3.8% according to the CSO.

<sup>12</sup> According to the CSO, compared to the 1st quarter of the previous year.

<sup>13</sup> Forecasts of the European Commission, Brussels, 7.04.2003.

<sup>14</sup> 3.8% according to the CSO.

<sup>15</sup> Monthly and quarterly economic information, Warsaw, CSO, April 2004.

In 2003 the countries of the EU-10 recorded the economic growth of 3.6% – higher by 1.2 percentage point than in 2002. According to forecasts of the European Commission, economic growth would amount to 4.0% in 2004 and to 4.2% in 2005. Many factors suggest that the GDP growth rate in the EU-10 countries is now coming close to the level from the second half of the 1990's (average growth rate in 1996–2000 reached 4.1%).

Growth of GDP in the EU-10 countries is higher than the growth rate in countries of EU-15, but lower than the growth rate of the global economy. The forecasts of the European Commission and the International Monetary Fund suggest that the GDP growth of countries of EU-10 is coming closer to the growth rate of the global economy. The highest growth rate among the new members of the European Union (EU-10) was seen in Lithuania, and the lowest one in Malta.

Gross domestic product per capita in Poland in 2003 (measured according to purchasing power parity) amounted to USD 10,854 (data of the IMF) and was 5.4 times smaller than in Luxembourg (in 2003 that country had the highest GDP per capita); 3.4 times smaller than in the USA; and also 1.6 times smaller than in Portugal (which has the lowest GDP per capita among countries of the EU-15).

Gross Domestic Product per capita in Poland in 2003 amounted to only 42.7% of the average of countries of the EU-15 (46% of EU-25). According to forecasts of the European Commission<sup>16</sup>, this proportion is expected to reach 43.6% in 2003 and 44.5% in 2005.

Table 11. GDP per capita according to purchasing power parity (EU-15 = 100)

|                 | 2001  | 2002  | 2003 est. | 2004 forecast | 2005 forecast |
|-----------------|-------|-------|-----------|---------------|---------------|
| Austria         | 112.0 | 110.9 | 111.0     | 110.7         | 110.6         |
| Belgium         | 107.0 | 106.5 | 106.9     | 106.8         | 106.8         |
| Finland         | 104.2 | 101.8 | 101.0     | 101.2         | 101.1         |
| France          | 104.8 | 104.6 | 104.1     | 103.6         | 103.5         |
| Greece          | 67.2  | 70.8  | 73.2      | 75.0          | 75.9          |
| Spain           | 84.3  | 86.1  | 87.4      | 88.0          | 88.8          |
| Ireland         | 117.7 | 125.4 | 120.2     | 119.9         | 121.4         |
| Luxembourg      | 194.4 | 188.8 | 187.9     | 187.2         | 188.3         |
| The Netherlands | 113.4 | 111.4 | 109.5     | 108.2         | 106.8         |

<sup>16</sup> European Commission, Statistical Annex of European Economy, Spring 2004.

|                | 2001  | 2002  | 2003 est. | 2004 forecast | 2005 forecast |
|----------------|-------|-------|-----------|---------------|---------------|
| Germany        | 100.5 | 99.6  | 99.0      | 98.7          | 98.3          |
| Portugal       | 70.6  | 70.9  | 68.8      | 67.9          | 67.5          |
| Italy          | 100.1 | 98.4  | 98.2      | 97.5          | 97.5          |
| EU-12          | 98.6  | 98.2  | 97.9      | 97.7          | 97.6          |
| Denmark        | 115.4 | 112.3 | 112.1     | 112.5         | 112.2         |
| Sweden         | 106.2 | 104.7 | 104.6     | 104.6         | 104.5         |
| Great Britain  | 105.1 | 107.4 | 108.9     | 110.2         | 110.5         |
| EU-15          | 100   | 100   | 100       | 100           | 100           |
| Cyprus         | 78.4  | 76.4  | 77.5      | 77.6          | 78.3          |
| Czech Republic | 60.6  | 61.9  | 63.8      | 64.8          | 66.1          |
| Estonia        | 38.6  | 40.1  | 41.2      | 43.1          | 45.5          |
| Lithuania      | 37.2  | 39.1  | 42.7      | 45.0          | 47.0          |
| Latvia         | 33.4  | 34.8  | 37.1      | 38.7          | 40.4          |
| Malta          | 64.8  | 64.3  | 64.2      | 63.7          | 63.5          |
| POLAND         | 41.9  | 41.7  | 42.7      | 43.6          | 44.5          |
| Slovakia       | 44.7  | 47.1  | 48.3      | 48.6          | 49.1          |
| Slovenia       | 67.9  | 69.0  | 71.3      | 70.5          | 71.7          |
| Hungary        | 51.5  | 53.4  | 55.1      | 56.1          | 57.2          |
| EU-10          | 46.6  | 47.3  | 48.7      | 49.6          | 50.7          |
| EU-25          | 91.3  | 91.4  | 91.7      | 91.8          | 92.0          |
| USA            | 138.9 | 139.8 | 141.3     | 142.7         | 142.6         |
| Japan          | 104.5 | 103.2 | 104.7     | 106.0         | 106.0         |

Source: European Commission, Statistical Annex of European Economy, Spring 2004, 29.03.2004

### 1.2.2. Inflation

In 2003, inflation in the European Union (EU-15) amounted to 2.0%. It was lower by 0.1 percentage point as compared to the previous year. The countries with the highest inflation levels in 2003 were Ireland, Greece and Portugal. The lowest increase in consumer prices was seen in Germany, Finland and Austria.

In the EU-10 group of countries, inflation reached 2.1% in 2003. It was lower by 0.6 percentage point compared to the previous year. The highest inflation rate in 2003 was seen in Slovakia, Slovenia, Hungary and Cyprus. The prices rose the slowest in Poland and Estonia; and Lithuania and the Czech Republic experienced deflation.

Inflation in the countries of the EU-25 reached 2% in 2003. It was slightly higher than in 2002 (2.1%) and than in 2001 (2.5%). According to forecasts, the average inflation in countries of the EU-25 will drop to 1.8% in 2004–2005.

Table 12. Inflation rate in the countries of the EU, the USA and Japan  
(harmonised consumer price index, change in % compared to the previous year)

| Country         | 2001 | 2002 | 2003 est.         | 2004 forecast | 2005 forecast |
|-----------------|------|------|-------------------|---------------|---------------|
| Austria         | 2.3  | 1.7  | 1.3               | 1.4           | 1.3           |
| Belgium         | 2.4  | 1.6  | 1.5               | 1.5           | 1.6           |
| Finland         | 2.7  | 2.0  | 1.3               | 0.4           | 1.5           |
| France          | 1.8  | 1.9  | 2.2               | 1.9           | 1.5           |
| Greece          | 3.7  | 3.9  | 3.4               | 3.4           | 3.5           |
| Spain           | 2.8  | 3.6  | 3.1               | 2.4           | 2.3           |
| Ireland         | 4.0  | 4.7  | 4.0               | 2.1           | 2.3           |
| Luxembourg      | 2.4  | 2.1  | 2.5               | 2.0           | 1.7           |
| The Netherlands | 5.1  | 3.9  | 2.2               | 1.4           | 0.7           |
| Germany         | 1.9  | 1.3  | 1.0               | 1.3           | 1.1           |
| Portugal        | 4.4  | 3.7  | 3.3               | 2.0           | 2.2           |
| Italy           | 2.3  | 2.6  | 2.8               | 2.2           | 1.9           |
| EU-12           | 2.4  | 2.3  | 2.1               | 1.8           | 1.6           |
| Denmark         | 2.3  | 2.4  | 2.0               | 1.5           | 1.8           |
| Sweden          | 2.7  | 2.0  | 2.3               | 1.2           | 1.6           |
| Great Britain   | 1.2  | 1.3  | 1.4               | 1.6           | 1.9           |
| EU-15           | 2.2  | 2.1  | 2.0               | 1.8           | 1.7           |
| Cyprus          | 2.0  | 2.8  | 4.0               | 2.2           | 2.1           |
| Czech Republic  | 4.5  | 1.4  | -0.1              | 2.8           | 2.8           |
| Estonia         | 5.6  | 3.6  | 1.4               | 2.8           | 2.9           |
| Lithuania       | 1.3  | 0.4  | -1.1              | 1.0           | 2.2           |
| Latvia          | 2.5  | 2.0  | 2.9               | 4.0           | 3.5           |
| Malta           | 2.5  | 3.2  | 2.5               | 1.8           | 1.9           |
| POLAND          | 5.3  | 1.9  | 0.7 <sup>17</sup> | 2.3           | 3.0           |
| Slovakia        | 7.2  | 3.5  | 8.5               | 8.2           | 4.5           |
| Slovenia        | 8.6  | 7.5  | 5.7               | 3.6           | 3.2           |
| Hungary         | 9.1  | 5.2  | 4.7               | 6.9           | 4.6           |
| EU-10           | 5.7  | 2.7  | 2.1               | 3.8           | 3.3           |
| EU-25           | 2.5  | 2.1  | 2.0               | 1.8           | 1.8           |
| USA             | 2.8  | 1.6  | 2.3               | 1.4           | 1.2           |
| Japan           | -0.7 | -0.9 | -0.3              | 0.0           | 0.2           |

Source: EUROSTAT, <http://europa.eu.int/comm/newcronos>, (years 2001–2003).

European Commission, Statistical Annex of European Economy, Spring 2004, April 2004 (forecasts 2004–2005).

<sup>17</sup> 0.8% according to the Central Statistical Office.

### 1.2.3. Unemployment

Unemployment in Poland is one of the most important socio-economic problems of the country. In the medium-term perspective, it will remain so. This is due to the mix of economic conditions, tied to the still ongoing transformation of the economic system; and to the demographic conditions, as currently large groups of young people born in the periods of demographic high enter the labour market. As a result, unemployment in Poland has mainly a structural nature.

Table 13. Unemployment rates in countries of the European Union in 2000–2003

| Country         | 2000        | 2001        | 2002        | 2003        | Change<br>2000–2003 |
|-----------------|-------------|-------------|-------------|-------------|---------------------|
| Austria         | 3.7         | 3.6         | 4.3         | 4.4         | 0.7                 |
| Belgium         | 6.9         | 6.7         | 7.3         | 8.1         | 1.2                 |
| Denmark         | 4.4         | 4.3         | 4.6         | 5.6         | 1.2                 |
| Finland         | 9.8         | 9.1         | 9.1         | 9.0         | -0.8                |
| France          | 9.3         | 8.5         | 8.8         | 9.4         | 0.1                 |
| Greece          | 11.0        | 10.4        | 10.0        | 9.3         | -1.7                |
| Spain           | 11.3        | 10.6        | 11.3        | 11.3        | 0.0                 |
| Ireland         | 4.3         | 3.9         | 4.3         | 4.6         | 0.3                 |
| Luxembourg      | 2.3         | 2.1         | 2.8         | 3.7         | 1.4                 |
| The Netherlands | 2.9         | 2.5         | 2.7         | 3.7         | 0.8                 |
| Germany         | 7.8         | 7.8         | 8.6         | 9.3         | 1.5                 |
| Portugal        | 4.1         | 4.1         | 5.1         | 6.5         | 2.4                 |
| Sweden          | 5.6         | 4.9         | 4.9         | 5.6         | 0.0                 |
| Great Britain   | 5.4         | 5.0         | 5.1         | 5.0         | -0.4                |
| Italy           | 10.4        | 9.4         | 9.0         | 8.7         | -1.7                |
| <b>EU-15</b>    | <b>7.8</b>  | <b>7.4</b>  | <b>7.7</b>  | <b>8.0</b>  | <b>0.2</b>          |
| Czech Republic  | 8.7         | 8.0         | 7.3         | 7.8         | -0.9                |
| Cyprus          | 5.2         | 4.4         | 3.9         | 4.4         | -0.8                |
| Estonia         | 12.5        | 11.8        | 10.5        | 10.0        | -2.5                |
| Lithuania       | 15.7        | 16.1        | 13.6        | 12.7        | -3.0                |
| Latvia          | 13.7        | 12.9        | 12.6        | 10.5        | -3.2                |
| Malta           | 7.0         | 6.7         | 7.5         | 8.2         | 1.2                 |
| <b>POLAND</b>   | <b>16.4</b> | <b>18.5</b> | <b>19.8</b> | <b>19.8</b> | <b>3.4</b>          |
| Slovakia        | 18.7        | 19.4        | 18.7        | 17.1        | -1.6                |
| Slovenia        | 6.6         | 5.8         | 6.1         | 6.5         | -0.1                |
| Hungary         | 6.3         | 5.6         | 5.6         | 5.8         | -0.5                |
| <b>EU-10</b>    | <b>13.6</b> | <b>14.5</b> | <b>14.8</b> | <b>14.3</b> | <b>0.7</b>          |
| <b>EU-25</b>    | <b>8.8</b>  | <b>8.5</b>  | <b>8.8</b>  | <b>9.0</b>  | <b>0.2</b>          |

Source: EUROSTAT.

In the countries of the EU-15, the unemployment rates in 2003 ranged from 3.7% in Luxembourg and the Netherlands to 11.3% in Spain. In most countries, unemployment fell in 2000–2003. The drop was the strongest in Portugal (2.4 percentage points).

In countries of the EU-10, the difference between unemployment rates in 2003 was even higher: from 4.4% in Cyprus to 19.8% in Poland. However, in 2000–2003, unemployment rate fell in most of these countries. An increase was recorded only in Poland (by 3.4 percentage points) and in Malta (by 1.2 percentage point).

As a result, a two-digit unemployment rate in the EU-25, aside from Poland and Slovakia, was found in Lithuania, Spain, Estonia and Latvia.

Among the countries of the European Union, aside from the varied level of unemployment, there are structural differences in the population of the unemployed. These differences apply to such sub-populations as youths aged 15–24, or long-term unemployed persons, who remain without employment for over 12 months.

Table 14. Selected unemployment indices in countries of the European Union in 2000–2002

| Country         | Unemployment rate (15–24) |      |      |                  | Rate of long-term unemployment |      |      |                  |
|-----------------|---------------------------|------|------|------------------|--------------------------------|------|------|------------------|
|                 | 2000                      | 2001 | 2002 | Change 2000–2002 | 2000                           | 2001 | 2002 | Change 2000–2002 |
| Austria         | 5.3                       | 5.8  | 6.8  | 1.5              | 1.0                            | 0.9  | 0.8  | -0.2             |
| Belgium         | 17.0                      | 17.5 | 18.2 | 1.2              | 3.7                            | 3.2  | 3.6  | -0.1             |
| Denmark         | 7.0                       | 8.4  | 7.7  | 0.7              | 1.0                            | 0.8  | 0.9  | -0.1             |
| Finland         | 21.4                      | 19.8 | 21.0 | -0.4             | 2.8                            | 2.5  | 2.3  | -0.5             |
| France          | 19.7                      | 19.0 | 20.0 | 0.3              | 3.6                            | 3.0  | 2.7  | -0.9             |
| Greece          | 29.4                      | 28.0 | 26.4 | -3.0             | 6.0                            | 5.4  | 5.1  | -0.9             |
| Spain           | 22.6                      | 21.4 | 22.2 | -0.4             | 4.7                            | 3.9  | 3.9  | -0.8             |
| Ireland         | 6.7                       | 6.7  | 8.0  | 1.3              | 1.6                            | 1.2  | 1.3  | -0.3             |
| Luxembourg      | 7.2                       | 7.3  | 8.3  | 1.1              | 0.6                            | 0.6  | 0.8  | 0.2              |
| The Netherlands | 5.6                       | 5.3  | 5.2  | -0.4             | 0.7                            | 0.6  | 0.7  | 0.0              |
| Germany         | 8.5                       | 8.4  | 9.7  | 1.2              | 3.9                            | 3.8  | 4.0  | 0.1              |
| Portugal        | 8.8                       | 9.2  | 11.5 | 2.7              | 1.7                            | 1.5  | 1.8  | 0.1              |
| Sweden          | 10.5                      | 10.9 | 11.8 | 1.3              | 1.4                            | 1.0  | 1.0  | -0.4             |
| Great Britain   | 12.3                      | 11.9 | 12.1 | -0.2             | 1.5                            | 1.3  | 1.1  | -0.4             |
| Italy           | 30.7                      | 28.1 | 27.2 | -3.5             | 6.4                            | 5.8  | 5.3  | -1.1             |
| EU-15           | 15.4                      | 14.6 | 15.1 | -0.3             | 3.5                            | 3.1  | 3.0  | -0.5             |
| Czech Republic  | 17.8                      | 17.3 | 16.9 | -0.9             | 4.2                            | 4.2  | 3.7  | -0.5             |
| Cyprus          | 11.5                      | 10.3 | 9.7  | -1.8             | 1.3                            | 0.9  | 0.8  | -0.5             |
| Estonia         | 23.6                      | 23.5 | 17.7 | -5.9             | 5.9                            | 5.7  | 4.8  | -1.1             |
| Lithuania       | 29.3                      | 30.2 | 21.4 | -7.9             | 8.3                            | 9.0  | 7.0  | -1.3             |

| Country       | Unemployment rate (15–24) |             |             |                  | Rate of long-term unemployment |            |             |                  |
|---------------|---------------------------|-------------|-------------|------------------|--------------------------------|------------|-------------|------------------|
|               | 2000                      | 2001        | 2002        | Change 2000–2002 | 2000                           | 2001       | 2002        | Change 2000–2002 |
| Latvia        | 21.4                      | 23.0        | 24.6        | 3.2              | 7.9                            | 7.2        | 5.8         | -2.1             |
| Malta         | 14.2                      | 16.1        | 17.7        | 3.5              | 4.6                            | 3.2        | 3.2         | -1.4             |
| <b>POLAND</b> | <b>36.3</b>               | <b>39.8</b> | <b>41.7</b> | <b>5.4</b>       | <b>7.5</b>                     | <b>9.3</b> | <b>10.9</b> | <b>3.4</b>       |
| Slovakia      | 37.1                      | 39.0        | 37.3        | 0.2              | 10.1                           | 11.4       | 12.1        | 2.0              |
| Slovenia      | 16.2                      | 16.0        | 15.3        | -0.9             | 4.1                            | 3.5        | 3.3         | -0.8             |
| Hungary       | 12.1                      | 10.9        | 11.9        | -0.2             | 3.0                            | 2.5        | 2.4         | -0.6             |
| EU-10         | 28.6                      | 31.3        | 31.9        | 3.3              | 6.5                            | 7.5        | 8.1         | 1.6              |
| EU-25         | 17.6                      | 17.3        | 17.8        | 0.2              | 4.0                            | 3.9        | 3.8         | -0.2             |

Source: EUROSTAT.

Poland has the highest unemployment rate of the young people, aged 15 to 24, among all countries of the EU-25. It is also one of the countries with the highest long-term unemployment rate. Both indices have shown a downward tendency in most EU countries, but Poland experienced their significant increase.

Both the level and structure of the Polish unemployment vary significantly from the situation found in countries of the EU-15 and EU-10. Unemployment in Poland shows also negative differences in comparison to the average level of other indices: the overall unemployment rate, unemployment rate among the young people, or the long-term unemployment rate. This has a negative influence on the competitiveness of the Polish economy, because a situation of long-term high unemployment level means that the basic production means – the labour – is under-utilised. It carries the threat of permanent loss of vocational qualifications of the unemployed persons.

#### 1.2.4. Foreign trade

In 2003, the economic processes, which supported the openness of Polish economy, continued. A significant increase in the turnover of foreign trade – including an increase of export by 30.6% and import by 23.4% (measured in terms of value in US dollars, according to SAD customs statistics) – caused an increase of Poland's share in the commodities exchange of the EU-15, from 1.9% in 2001 to 2.2% in 2003. Measured in euro, the value rose from 2.8% to 3.3%. This share is still small, compared to the share of highly developed economies of Western Europe, such as German, French or British, whose total share in the global commodity exchange of the EU-15 amounts almost to 70%. However, the increasing share of Polish trade is a proof of the positive results of transformation



of the country's economy, which consequently strives to increase its role in the international exchange processes.

Table 15. Poland's commodity exchange compared to the overall commodity exchange of EU-15 (EUR billion)

|                 | Total export |       |          | Total import |       |         | Balance |       |
|-----------------|--------------|-------|----------|--------------|-------|---------|---------|-------|
|                 | 2002         | 2003  | change % | 2002         | 2003  | change% | 2002    | 2003  |
| Austria         | 83.2         | 84.7  | 2.0      | 82.8         | 86.7  | 5.0     | 0.4     | -1.9  |
| Belgium         | 228.6        | 225.7 | -1.0     | 210.3        | 208.3 | -1.0    | 18.3    | 17.4  |
| Denmark         | 60.8         | 60.0  | -1.0     | 53.2         | 51.8  | -3.0    | 7.6     | 8.3   |
| Finland         | 47.7         | 46.8  | -2.0     | 36.2         | 37.1  | 3.0     | 11.6    | 9.7   |
| France          | 350.8        | 341.0 | -3.0     | 348.2        | 344.1 | -1.0    | 2.6     | -3.0  |
| Greece          | 10.9         | -     | -        | 33.1         | -     | -       | -22.1   | -     |
| Spain           | 132.9        | 131.4 | 1.0      | 174.6        | 177.7 | 2.0     | -41.7   | -43.6 |
| Ireland         | 93.3         | 81.9  | -12.0    | 55.4         | 47.1  | -15.0   | 37.9    | 34.9  |
| Luxembourg      | 10.8         | 11.8  | 9.0      | 13.9         | 14.4  | 4.0     | -3.1    | -2.6  |
| The Netherlands | 258.1        | 259.4 | 0.0      | 231.9        | 231.0 | 0.0     | 26.2    | 28.4  |
| Germany         | 651.3        | 661.6 | 2.0      | 518.5        | 531.9 | 3.0     | 132.8   | 129.6 |
| Portugal        | 28.1         | 27.5  | -2.0     | 42.4         | 39.6  | -7.0    | -14.3   | -12.2 |
| Sweden          | 86.2         | 89.4  | 4.0      | 70.8         | 73.0  | 3.0     | 15.4    | 16.3  |
| Great Britain   | 296.3        | 268.3 | -9.0     | 366.2        | 344.0 | 6.0     | -69.9   | -75.7 |
| Italy           | 269.1        | 258.2 | -4.0     | 261.2        | 257.1 | -2.0    | 7.8     | 1.1   |
| POLAND          | 43.5         | 46.4  | 7.0      | 58.5         | 59.5  | 2.0     | -15.0   | -13.1 |

Source: Communiqués of Eurostat, 42/2004 and 22/2004

Table 16. Commodity exchange of EU-10 with countries of EU-15 (EUR billion)

|                | Export |      |         | Import |      |         | Balance |      |
|----------------|--------|------|---------|--------|------|---------|---------|------|
|                | 2002   | 2003 | change% | 2002   | 2003 | change% | 2002    | 2003 |
| Czech Republic | 27.8   | 30.0 | 8.0     | 25.9   | 26.8 | 3.0     | 1.9     | 3.2  |
| Estonia        | 2.5    | 2.7  | 10.0    | 2.9    | 3.1  | 5.0     | -0.5    | -0.3 |
| Cyprus         | 0.2    | 0.2  | -4.0    | 1.8    | 1.7  | -6.0    | -1.6    | -1.5 |
| Latvia         | 1.5    | 1.6  | 8.0     | 2.3    | 2.4  | 4.0     | -0.8    | -0.8 |
| Lithuania      | 2.7    | 2.6  | -4.0    | 3.6    | 3.8  | 4.0     | -0.9    | -1.1 |
| Hungary        | 27.4   | 27.5 | 0.0     | 22.5   | 23.2 | 3.0     | 5.0     | 4.4  |
| Malta          | 1.0    | 0.9  | -6.0    | 1.9    | 1.9  | 2.0     | -0.9    | -1.0 |
| POLAND         | 29.9   | 31.9 | 7.0     | 36.1   | 36.4 | 1.0     | -6.2    | -4.5 |
| Slovenia       | 6.5    | 6.6  | 1.0     | 7.9    | 8.2  | 5.0     | -1.4    | -1.6 |
| Slovakia       | 9.2    | 10.6 | 15.0    | 8.8    | 9.3  | 5.0     | 0.4     | 1.3  |

Source: Communiqué of Eurostat, 22/2004.

Among the ten newly accepted members of the European Community (EU-10), Poland is the leader in terms of the absolute value of commodity exchange with countries of the EU-15. This is illustrated in the table below.

#### 1.2.5. Industrial output

In 2003, the sold industrial output (of entities with more than 9 workers) was higher by 8.7% than in the previous year. In 2002, industrial enterprises increased their output only by 1.5%. This situation was supported by a higher dynamics of production activity (growth by 10.5%, as compared to 2.1% in 2002). In electricity, gas and water supply, production rose by 1.4%. Meanwhile, the mining and quarrying section saw a decline of its production by 3.6%.

Table 17. Dynamics of industrial production in countries of the EU  
(fixed prices, previous year = 100)

| Country         | 2002         | 2003         |
|-----------------|--------------|--------------|
| Austria         | 100.9        | 102.1        |
| Belgium         | 101.5        | 98.5         |
| Denmark         | 101.4        | 100.5        |
| Finland         | 101.7        | 100.7        |
| France          | 98.8         | 99.5         |
| Greece          | 100.4        | 101.5        |
| Spain           | 100.1        | 101.5        |
| Ireland         | 107.8        | 105.6        |
| Luxembourg      | 101.0        | 103.0        |
| the Netherlands | 99.0         | 98.8         |
| Germany         | 98.0         | 100.7        |
| Portugal        | 99.7         | 100.2        |
| Sweden          | 100.3        | 102.0        |
| Great Britain   | 97.4         | 99.3         |
| Italy           | 98.7         | 99.5         |
| EU-15           | 99.0         | 100.2        |
| Cyprus          | 100.1        | 99.4         |
| Czech Republic  | 104.8        | 105.6        |
| Estonia         | 105.9        | 110.2        |
| Lithuania       | 103.2        | 116.1        |
| Latvia          | 105.8        | 106.4        |
| <b>POLAND</b>   | <b>101.1</b> | <b>108.7</b> |
| Slovakia        | 106.7        | 105.0        |
| Slovenia        | 102.4        | 101.3        |
| Hungary         | 102.6        | 105.5        |
| EU-10           | .            | .            |

Source: Information on the social and economic situation of the country, CSO, Q1 of 2004.

Compared to economies of the EU countries, the dynamics of domestic industrial output was as follows.

A significant worsening of the economic situation in countries of the European Union, which occurred in recent years, finds its reflection in the stagnation of industrial output levels. In 2001, industrial output remained on the level from the previous year, in 2002 it fell by 1.0%, and in 2003 rose by 0.2%.

In 2003, the dynamics of industrial output varied in the individual countries. Five countries registered a decline of production (Belgium, France, the Netherlands, Great Britain and Italy); and the remaining countries saw a slight increase. The largest growth, by 5.6%, was achieved by Ireland.

Countries of the EU-10 achieved much better ratios of production dynamics than countries of the EU-15. Most of the new EU member countries achieved higher growth levels than in the previous year, with the exception of Cyprus, where production dropped by 0.6%. The highest growth was achieved by Lithuania (16.1%), Estonia (10.2%) and Poland (8.7%).

For Poland, the year 2003 was a period of breaking stagnation of industrial dynamics, present in 2000–2002.

### **1.3. The pyramid of competitiveness**

In 1997, the European Commission proposed the so-called „pyramid of competitiveness”<sup>18</sup>

This pyramid is used to develop various models of competitiveness on the macro- and micro-economic levels.

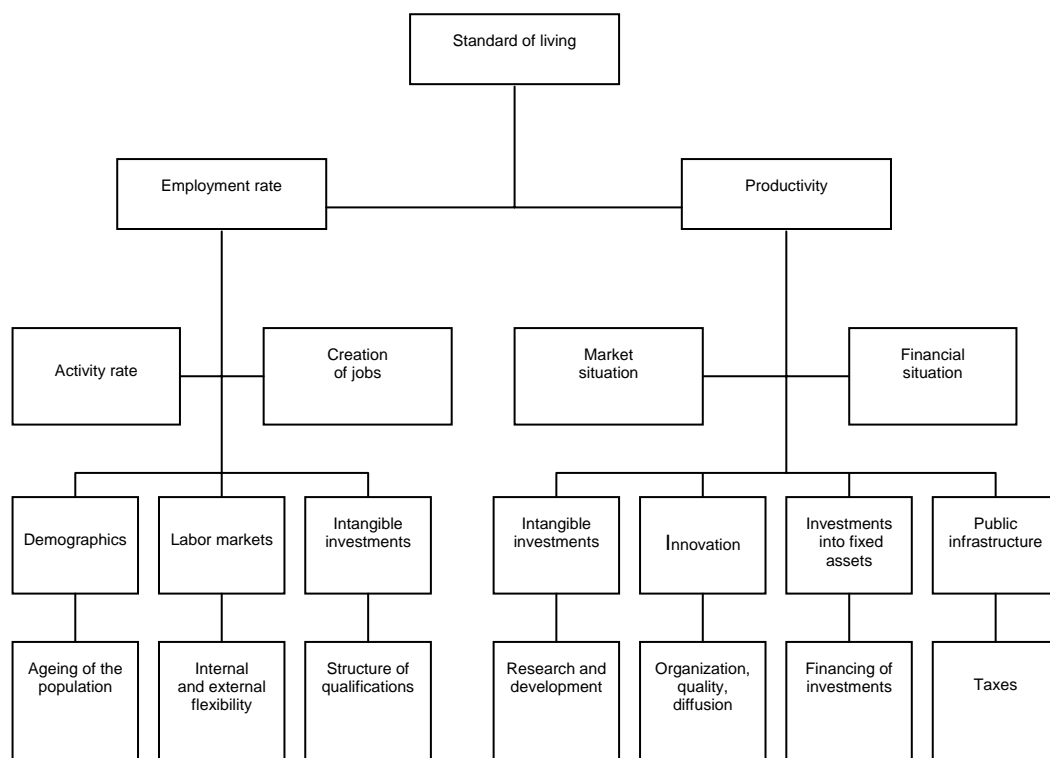
The competitiveness pyramid presents a set of factors, which determine competitiveness. The most important factor – standard of living – is placed at the top of the pyramid. Standard of living is considered to be a synthetic competitiveness indicator for any given economy (GDP per capita). This indicator is influenced by two factors: the employment rate and productivity. They are further broken down into individual factors determining both values. Employ-

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<sup>18</sup> Source: Benchmarking the competitiveness of the European industry, COM (96) 463 final, Brussels, 9.10.1996, in: A. Hildebrandt, *Competitiveness – attempts to define and measure the event*, the European Communities, No. 3 (126) 2002, page 69.

ment rate is influenced by the ratio of professional activity, creation of new jobs, labour market, demographic aspects of the society and intangible investments, defined as investment into human resources (increase of qualifications). Productivity is influenced primarily by innovations, research and development outlays, investments in fixed assets and the financial situation (investment financing, taxes).

**Diagram The pyramid of competitiveness**



Source: *Benchmarking the competitiveness of the European industry, COM (96) 463 final, Brussels, 9.10.1996, in: A Hildebrandt, Competitiveness – attempts to define and measure the event, the European Communities, No. 3 (126) 2002, page 69.*

### 1.3.1. Factors tied to employment and labour market

A measure of population's involvement in the labour process is the employment rate – the share of employed in the overall number of population aged 15 and over. In Poland, this rate is much lower than in the EU-15 countries, and

contrary to the EU trend it does not show an upward tendency. The employment rate fell from 45.5% in 2001 to 44.2% in 2003. For the population aged 15 to 64, the employment rate in 2002 in Poland amounted to 51.5%, while in the EU it was much higher, reaching the level of 64.3%. The average rate in countries of the EU-10 amounts to 55.9%, which is more than in Poland. This causes the employment rate in Poland to be lower than the average in 25 countries of the EU (62.9%).

The downward trend in the number of the professionally active population is a negative occurrence, which has serious economic and social consequences. This trend is still present, and is coupled with the growth of the number of professionally passive persons.

The number and structure of employed in the national economy is changing. According to data of the BAEL research, the population of employed was reduced by 3.4% in 2001; by 2.3% in 2002 and by less than 0.1% in 2003. It amounts to 13,718 thousand persons. The largest number of persons is employed in the service sector. The share of employed of the service sector rose from 51.0% in 2001 to 52.9% in 2003. The share of employed in the industry and agriculture sectors is decreasing. In 2002, according to the data of Eurostat, the comparable structure of employees in the individual sectors in Poland and in other EU countries was as follows:

Table 18. Structure of the employed

| Sectors     | POLAND | EU-15 | EU-10 | EU-25 |
|-------------|--------|-------|-------|-------|
| Total       | 100.0  | 100.0 | 100.0 | 100.0 |
| Agriculture | 19.3   | 4.1   | 13.0  | 5.4   |
| Industry    | 28.6   | 25.0  | 31.7  | 25.9  |
| Services    | 52.0   | 71.0  | 55.3  | 68.7  |

Source: *Employment in Europe 2003*.

The process of increasing business effectiveness in Poland was achieved largely through reduction of employment, which resulted in higher labour productivity. The increase of the so-called social labour productivity (amount of GDP in fixed prices per 1 employed in the national economy, on an average annual basis) reached the following values in the recent years: in 2001 – 1.6%, in 2002 – 3.7%, in 2003 – over 4%. The increase of labour productivity is a positive feature

of our development. However, its level compared to countries of the EU-15 is still low. In 2003, it constituted about 50% of the average labour productivity level in these countries (measures as per the purchasing power parity).

At the same time, no significant improvement was recorded in terms of labour costs reduction. These costs have a very high influence on competitiveness of the economy. The average nominal cost of labour per one employee in 2002 amounted to PLN 2,623. In 2001 it rose by 7.6%, and in 2002 by further 3.9%. In Poland, the labour costs are relatively low, compared to other countries of the EU. The share of costs related to employment in the GDP is below 45% in Poland, while in many countries of the EU-15 it exceeds 50%.

The education structure of the employed is constantly improving, which contributes to increase in the quality of the labour factor. In 2001–2003, the share of the employed with university level education rose significantly – from 15.6% to 19.1%. The share of the employed with high school and secondary vocational education changed from 29.8% to 29.1%; and with comprehensive high school education, from 6.8% to 7.6%. The share of employees with primary vocational education went significantly down – from 33.9% to 32.3%; and with junior high school, primary and incomplete primary education from 13.9% to 11.9%.

Due to demographic factors, large numbers of people born during the demographic boom are now entering the labour market. The process of population ageing is now very intense, which applies also to the population of the employed. This contributes to increasing an imbalance on the labour market. The number of young people without job is growing, and older persons of the productive age have increasing problem with finding employment. As a result, these conditions lead to a high level of unemployment, and to worse effectiveness in the use of workforce. This has a negative influence on the competitiveness of economy as a whole.

### 1.3.2. Factors tied to productivity

The total productivity of production means, known as the TFP index (Total Factor Productivity), which defines the total productivity of labour and capital, was higher in 2003 than in the previous year. It contributed 2.7% to the growth of GDP (3.8%), while the contribution of the labour factor was negative – 0.4%, and

capital contributed 1.4% (according to estimates on the basis of CSO data). This means that the economic growth was achieved without an increase of employment, and productivity rose significantly.

In 2003 investment outlays (gross fixed capital formation) in the national economy dropped for the third subsequent year. This time, the decline amounted to only 0.9%, compared to decline of 6.8% in 2002 and 8.8% in 2001. Since the second half of 2003, a revival in investment is observed. During the first quarter of 2004, gross fixed capital formation rose by 3.5%. It is believed that these are the symptoms of a durable economic revival and growth of investment, supported by a clear improvement in the financial situation of enterprises. The gross turnover profitability in the enterprise sector reached 2.8% in 2003 as compared to 0.8% in 2002 and 0.7% in 2001. Net turnover profitability amounted to, respectively, 1.7%, – 0.2% and – 0.3%.

Lack of financial means for investment activity was so far the most serious barrier for the development of enterprises and for improvement of their competitiveness. The share of bank credits in the financing of development is much smaller in Poland than in other countries, amounting to only several percent, while in the developed countries it reaches 70–80%. This is caused by the still high level of effective interest rates, high transaction costs which discourage banks from offering credits for small investment projects, requirements regarding loan collateral, etc.

A threat for the process of modernization of the economy and for increasing its competitiveness is a low volume of the incoming foreign direct investment (FDI). From the standpoint of economy's competitiveness, the level of FDI is very important. FDI serve not only to improve the ability to finance investment, but are also tied to technology transfer and improved access to outlet markets. In 2003, Poland received USD 6.4 billion of direct investment (according to data of the Polish Agency for Information and Foreign Investment, PAIIZ). This was slightly more than in 2002 when investment level reached USD 6.1 billion, compared to 7.1 billion in 2001 and 10.1 billion in the record year 2000.

The level of innovation in the Polish economy is low. It places Polish enterprises in a worse position during competition in the market. The innovation ratio

in Poland (the share of innovative companies in the overall number of industrial enterprises) dropped from 37.6% in 1994–1996 to barely 16.9% in 1998–2000<sup>19</sup>.

These enterprises do not meet the conditions necessary to obtain a competitive edge, which is gained by manufacturing products with the use of modern technologies; and by manufacturing products of high quality, confirmed with the relevant certificates. The report<sup>20</sup>, published by the ISO Secretariat in July 2003, shows that as at 31 December 2002 the number of ISO 9000 certificates in Poland was similar as in such member countries of the EU as Greece or Portugal.

This report proves also that the distance between Poland, Hungary and the Czech Republic in terms of the numbers of ISO 9000 certificates (these certificates confirm the compliance of quality systems with the requirements of international standards) has grown bigger, despite the fact that Poland has a much bigger economic potential than these countries. Of the 3.4 million firms registered in Poland, only 2,854 obtained the ISO 9000 or 14000 certificates (in Germany, about 45 thousand, and in Great Britain about 70 thousands – at the end of 2001).

The innovative abilities of the economy are assessed on the ratio of outlays for research and development activity to the Gross Domestic Product. In Poland, this ratio amounted to 0.59% in 2002 (in 2001 – 0.65%). In the countries of the European Union (EU-15), the average value of this index reached 1.99% in 2002. The outlays for research and development in Poland, measured as a proportion to GDP, have grown smaller in recent years (0.75% in 1999). The structure of outlays for research and development activity has become fixed and is negative from the perspective of the economy: the share of primary research is growing, while the share of applied research and development works decreases. The low share of development works in the outlays for R&D, which is known as the measure of closeness to the market, proves weak involvement of enterprises in the R&D activity.

The consequence of insufficient co-operation between science and economy is the level of knowledge-based economy. It is assessed by the OECD on the

<sup>19</sup> Decline of the index is caused mainly by changes in the methodology. The technological and organizational innovations were excluded from the overall catalogue of innovations.

<sup>20</sup> The ISO Survey of ISO 9000 and ISO 14001 Certificates – Twelfth cycle.



basis of a multi-factor synthetic index. This index for Poland is set at 6 points (23<sup>rd</sup> place), while Hungary has 31 points (6<sup>th</sup> place).

The tax system functioning in the economy is very important for the competitive position of enterprises. Poland commenced a complex reform of its tax system in 1999. Its purpose was to reduce the tax rates and to broaden the taxable basis. As a result of these changes, the revenues of the public sector consist of three main categories: indirect taxes (VAT – Poland has one of the highest rates in Europe), direct taxes on the revenues of individuals (PIT), of enterprises (corporate income tax, CIT) and social security contributions. Most direct and indirect taxes constitute the revenue of the state budget, while the social security contributions are transferred to the Social Insurance Institution (ZUS), the Health Fund and Pension Funds. Despite the subsequent changes in the tax system, enterprises see it as particularly burdensome and consider it one of the biggest obstacles hindering business (especially the social security contributions). From the beginning of 2004, the CIT rate has been set at 19% (reduced from 27% in 2003 and 28% in 2002). At the same time, part of the tax allowances and reliefs was liquidated.



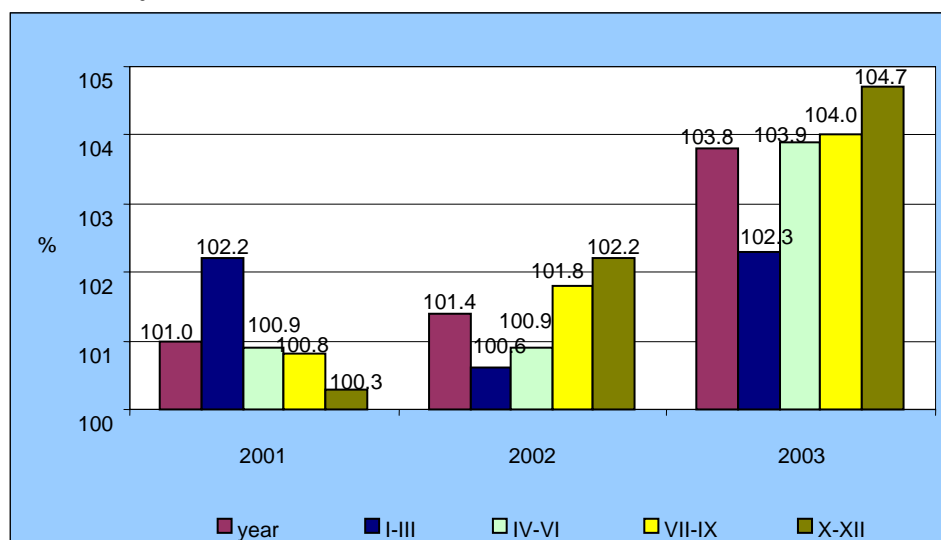
## Chapter 2

# GROSS DOMESTIC PRODUCT AND ITS CHARACTERISTIC

## 2.1. GDP dynamics and growth factors

After nine years of fast growth, Polish economy slowed down significantly in 2001–2002. The average rate of economic growth, which in 1992–2000 amounted almost to 5%, fell to about 1%. The beginning of the slow-down occurred in the third quarter of 2000, when the growth rate dropped from 5% to 3.1%. In the subsequent quarters, the growth rate kept going down, and in mid-2001 amounted to barely 0.3%. Since that time, the economy picked up from quarter to quarter. The second quarter of 2003, when the growth rate – measured in comparison to the same period of the previous year – rose to almost 4%, marks the end of the stagnation period in the economy. In the fourth quarter 2003, the rate of economic growth reached 4.7%; and in the first quarter of 2004 – 6.9%.

Chart 1. Dynamics of GDP in 2001–2003



Source: Statistical Bulletin of the Central Statistical Office, 6/2004.

During the whole 2003, growth of GDP reached 3.8%. The value of the GDP in current prices amounted to PLN 814.7 billion. Coupled with a slight decrease in the number of population, this caused an increase of GDP per capita. In 2003, it amounted to over PLN 21.3 thousand while in 2001 to PLN 19.6 thousand and in 2002 to PLN 20.2 thousand. After conversion according to the official exchange rate, this amounted to USD 4,952. According to estimates, the per capita value of GDP, according to the purchasing power parity, amounts to about USD 11 thousand.

From the demand side, the sources of GDP growth were varied in the recent years. Individual consumption has been rising systematically. Even during the period of economic slow-down it had positive (but relatively small) influence on growth. Collective consumption also served to increase the GDP, but its role was rather marginal. The role of gross accumulation in the growth of GDP was not uniform. As investments are a highly cyclical and that cycle is delayed<sup>21</sup>, investment had a positive influence on growth by the end of 2000. That influence was the strongest in the prosperous mid-1990s. When economy slowed down, the investment cycle hindered growth, which was not compensated by the positive influence of individual consumption. Net export almost mirrored the behaviours of investment. Until the end of 1999, export's influence on growth was negative. Import strongly prevailed over export, especially in the period of the fastest economic growth. In 2000, a significant decrease of trade deficit caused net export to become the main demand driver of economic growth.

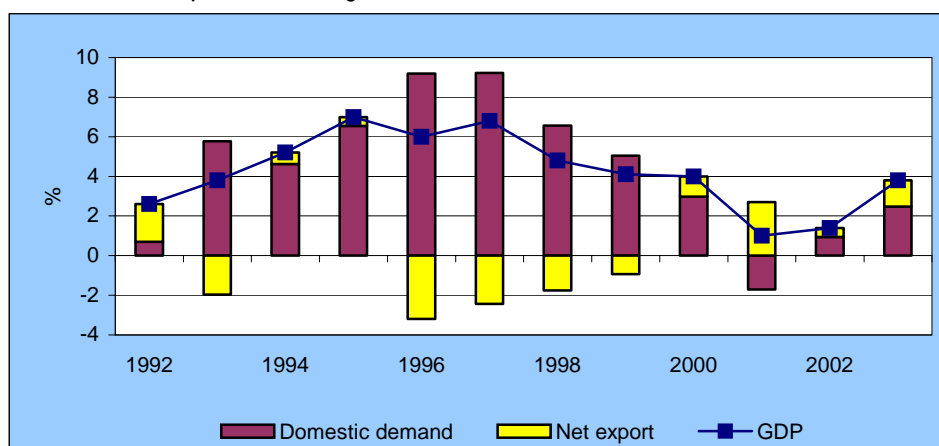
In 2003, economic growth was driven both by domestic demand and by net export (the influence of demand reached 2.5 percentage points, while net export accounted for 1.3 percentage point). This should be seen as positive, as the changes in domestic demand have had very strong influence on the growth rate. Given the size of the Polish economy, and the resulting orientation on internal market, it is extremely difficult to maintain high dynamics of GDP growth when domestic demand is getting weaker.

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<sup>21</sup> This means that the variations of investment dynamics in the economic cycle are parallel to (but much larger) the variations in product dynamics – investments grow during prosperous periods, and fall in periods of economic stagnation or recession. At the same time, a slight delay of investment dynamics in the economic cycle means that investments begin to rise (or fall) usually 1 or 2 quarters later than products. This is one of the so-called stylised facts of the economic cycle, and is universal for all market economies.

The positive influence of net export is a proof of improving competitiveness of the Polish economy. It is worth to stress that net export was the main factor, which allowed Poland to avoid recession in 2001. Growth of export occurred despite the worse foreign trade situation of Poland's main trade partners. Import of the EU-15 countries dropped by 0.1% in 2003. The situation was even worse in the countries which are the main recipients of goods from Poland – the value of export to Germany fell by EUR 13.4 billion (-2.5%), to France by EUR 4.1 billion (-1.1%), and to Italy by EUR 4 billion (-1.5%).

Chart 2. Decomposition of GDP growth in 1992–2003.



Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.

## 2.2. The role of individual sectors in the creation of GDP

In recent years, the sector of market services was one of the most stable areas of the Polish economy. It grew systematically by about 4–5% annually; and only slightly experienced the slowdown in 2001–2002 (despite that decrease, the growth of value added in that sector amounted at that time to 2.8%, while GDP rose by only 1%). Analysis of time series show that industry is the second factor with fundamental importance for economic growth. The economic slow-down of 2001–2002 was tied to the weaker dynamics of that sector. The additional nega-

tive factor was the construction sector, whose influence on the dynamics of the GDP was negative at that time. The sectors of non-market services and agriculture played a less important role in economic development.

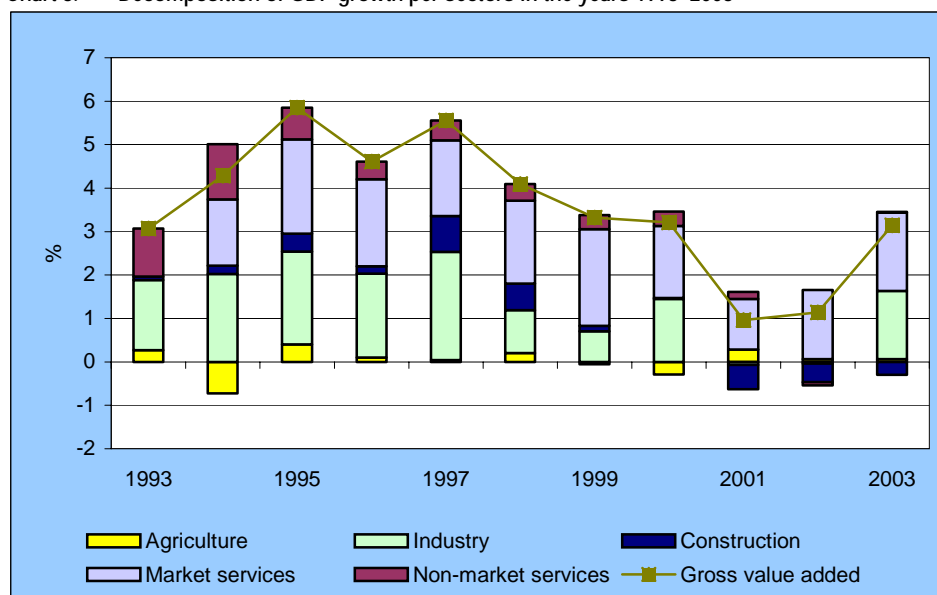
Table 19. The dynamics of Gross Domestic Product and gross value added in 1996–2004 (previous year = 100%)

|                        | 1996  | 1997  | 1998  | 1999  | 2000  | 2001  | 2002  | 2003  | 1q 2004 |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|---------|
| Gross Domestic Product | 106.0 | 106.8 | 104.8 | 104.1 | 104.0 | 101.0 | 101.4 | 103.8 | 106.9   |
| Gross value added      | 105.3 | 106.4 | 104.7 | 103.8 | 103.7 | 101.1 | 101.3 | 103.6 | 106.5   |
| – industry             | 107.5 | 110.2 | 104.1 | 103.1 | 106.5 | 99.7  | 99.8  | 107.6 | 114.5   |
| – construction         | 102.7 | 113.1 | 109.1 | 101.7 | 100.3 | 92.1  | 91.4  | 94.9  | 96.1    |
| – market services      | 105.6 | 104.7 | 105.0 | 105.6 | 104.1 | 102.8 | 104.0 | 104.1 | 105.7   |

Source: Information of the Central Statistical Office, Warsaw, 24.06.2004.

The acceleration of economic growth in 2003 was determined by positive influence of industry and market services. Construction remained a hindering element.

Chart 3. Decomposition of GDP growth per sectors in the years 1993–2003



Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.

Production activity was one of the main elements of the positive influence of industry. Its gross value added increased by 9.9%. Electricity, gas and water supply recorded an effective increase of gross value added, amounting to 2.4%. The only section where gross value added became smaller was the mining and quarrying sector.

In the construction sector, 2003 was the third subsequent year of recession. The gross value added, generated by this sector, fell by about 5.1% – only slightly less than in the previous years. This means that gross value added generated by the construction sector fell by a total of 18.6%, as compared to 2000.

In the sector of market services, effective growth dynamics of gross value added in 2003 reached 6.5% in commerce, and 4.6% in transportation.

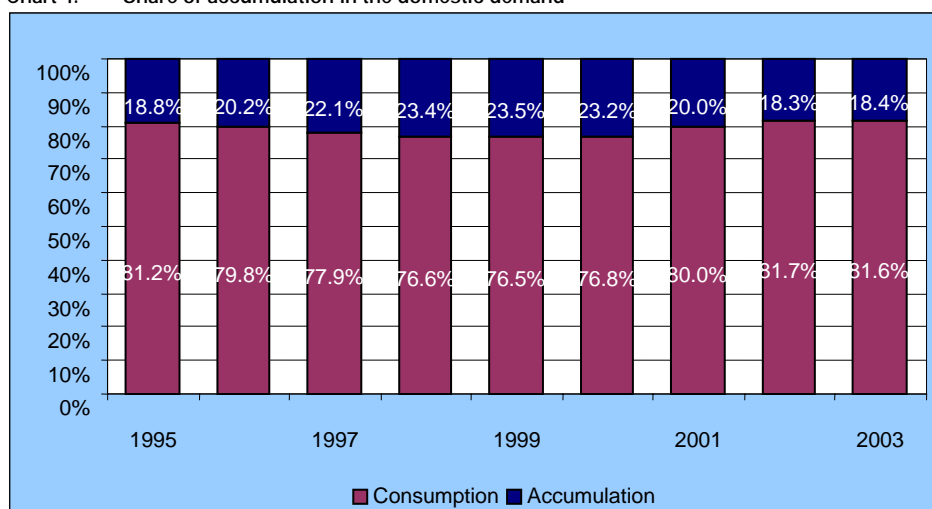
### **2.3. Decomposition of GDP into consumption and accumulation**

The weaker dynamics of accumulation and the systematic, although varied, growth of consumption, caused significant changes in the structure of GDP.

After the years when accumulation played a more important role in domestic demand, since 2000 a decrease was registered. The decrease brought accumulation down to the level seen before 1995 (18–19% of total domestic demand). It is worth to add that the share of accumulation in the GDP in Poland is similar as in other EU-15 countries, while being much lower than in other new EU members from Central and Eastern Europe (in 2002, it reached 28.1% in the Czech Republic, 25.4% in Hungary; and as much as 31.4% in Estonia).

The dynamics of private consumption in 2003, similarly as in the previous year, was higher than the dynamics of registered disposable income of households. Such situation suggests a decline of the savings of households, and a systematic increase of the gray area of the economy. It is estimated that effective income on hired labour rose in 2003, after a decrease in 2002. The improvement results from a smaller reduction of employment in the enterprise sector, and a higher effective growth of salaries. The growth of salaries in entities financed from the state budget was also higher; and the effective value of retirement and disability pensions also rose.

Chart 4. Share of accumulation in the domestic demand



Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.

Table 20. Dynamics of consumption in 2000–2003 (previous year = 100)

| Description       | 2000  | 2001  | 2002  | 2003  |
|-------------------|-------|-------|-------|-------|
| Total consumption | 102.5 | 101.7 | 102.8 | 102.5 |
| – private         | 102.8 | 102.0 | 103.3 | 103.1 |
| – public          | 101.3 | 100.6 | 100.4 | 100.4 |

Source: Small Statistical Yearbook of the CSO, 2004.

At the same time, in 2003 the level of deposits in banks fell (by PLN 3.5 billion), while the value of credits rose by PLN 12.2 billion. The volume of savings placed in investment funds rose. Their total volume at the end of 2003 amounted to PLN 30.1 billion, as compared to PLN 20.3 billion at the end of 2002.

## 2.4. The role of production factors in the growth of GDP

An analysis of the role of various factors in the growth of GDP shows that an increase in the productivity of production factors plays a decisive role. The reasons for this situation are tied to the structural changes of the Polish economy. The far-reaching rationalization of the use of capital and labour, coupled with the limited opportunities for capital accumulation, resulted in the increased productiv-



ity of production factors. The role of capital in the shaping of economic growth is small. Even the inflow of foreign capital does not fully account for economic growth in Poland. At the same time, among all other factors which cause the growth of productivity, knowledge and know-how brought by foreign investments, together with rapid development of education, are named as very important. The role of labour as a factor determining economic growth is largely hard to identify. Because of modern production methods, labour should not be considered as a homogenous factor influencing the economy – this would cause significant errors. For that reason, the measurement of labour's share should contain the elements of human capital – it should take into account the education levels and range of skills possessed by the employees.

In the coming years, we expect to see a further increase of the share of labour factor in economic growth. This should occur both due to the improvement in the quality of human capital, as well as to the overall increase in employment. An analysis of the role of capital in the economic growth should also take into account the quality of that capital. As a result of economic transformation, the quality of capital resources has improved significantly, and the institutional environment puts pressure on its rational use.

In order for capital and labour to be able to directly influence the dynamic economic growth, it is necessary to act to change the institutional environment – both for the labour market and capital. Positive elements of these changes include the higher flexibility of the labour market, removal of the system of incentives for leaving the ranks of the employed, development of the capital market, increased importance of investment funds and open pension funds in the allocation of capital.

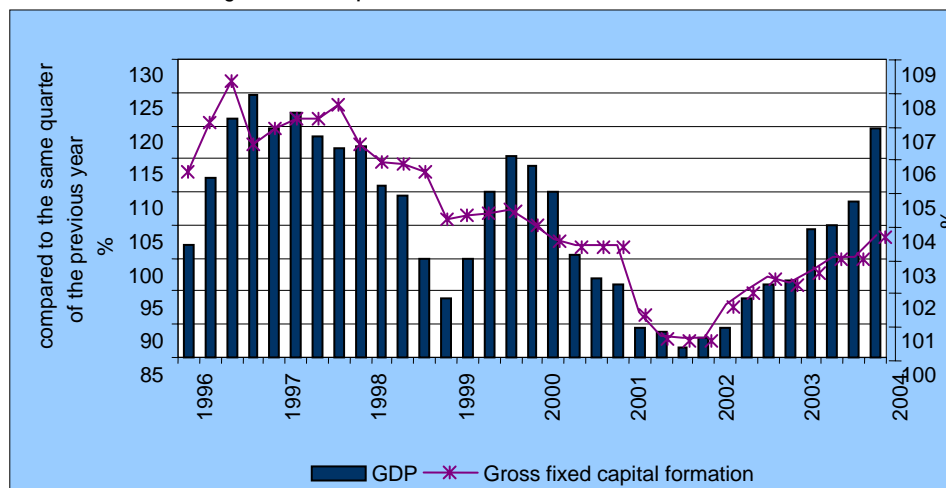
## **2.5. The influence of investments on the dynamics of GDP**

Investment outlays are a good forecast for the development of economy. They are a proof of the investors' moods and their assessment of the future economic situation.

Investments are the most pro-cyclical growth factor. A weakening in the dynamics of investment outlays was observed in the 1 quarter of 1998 and caused

a reduction in the dynamics of economic growth. A rapid decrease in investment outlays occurred in 2001 and contributed to further weakening of that dynamics.

Chart 5. GDP and gross fixed capital formation in 1996–2004



Source: Data of the Central Statistical Office.

In 2003, a moderate improvement was observed in the area of investment activity. This was the third subsequent year of decreasing gross fixed capital formation, but the size of that decline was much smaller than in 2001–2002. Important signals that the investment demand is picking up were observed in the second half of 2003. They were concentrated in the enterprise sector, in particular in the manufacturing activity. High increases of investment outlays in some sections resulted partly from the low investment activity in the previous years (the maximum level of these outlays in overall production activity was seen in 1998). However, in the motor vehicle industry and in the production of radio and television equipment, 2003 was the second subsequent year of very high increase of investment outlays. In the coming years, this should result in an increase of industrial output in these sections<sup>22</sup>. In the other sections of industry, the revival of investment demand was delayed, which could be explained with the still poor economic situation in the global economy; and growth of uncertainty in Poland, tied to the status of public finances and plans for their improvement.

<sup>22</sup> Data for the first quarter of 2004 indeed confirms that.

The mirrored activities of investment and net export as factors determining economic growth<sup>23</sup> in Poland is not accidental.

This is tied largely to the rate of domestic savings, which is low and remains below 22%. In a situation of investment boom, when the rate of gross investment reaches 25%, domestic savings are insufficient to cover the demand on capital, and capital must be imported. Its large portion appears as increased deficit in the account of commodities turnover, caused by rising investment and intermediate import. In times when the economy slows down, the dynamics of investment and dynamics of import grows weaker at a much stronger rate than dynamics of export. This translates into an improved trade balance and positive influence of net export on the growth of GDP. The strong ties between the dynamics of investment and dynamics of import in the situation of low domestic savings causes a situation in Poland where a parallel high influence on economic growth of gross accumulation and net export is possible only for brief periods of time. In consequence, the investment revival expected in 2004 must cause a decrease in net export as the source of growth. In 2005, export's contribution to the economic growth would probably be negative.

The inflow of foreign savings is a source of financing for the gap between the rate of gross accumulation and the rate of domestic savings. An important part of this inflow takes the form of foreign direct investments. According to the data of the Polish Agency for Information and Foreign Investment (PAIIZ), at the end of 2003, the cumulative value of FDI in Poland reached USD 72.7 billion. In the years 1994–2003. The share of foreign investments in the GDP ranges from 1.6% to 6.4%. The role of foreign capital in the economic growth is not limited to financing part of the investments on a macro scale. Foreign investments have become an important channel for spreading knowledge and improving the quality of production of Polish enterprises. This is done both directly – as import of new technologies, introduction of modern management forms and organization of productions in companies with foreign capital – and indirectly, in the form of competitive pressure exerted on domestic entrepreneurs.

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<sup>23</sup> It should be stressed that investments in fixed assets have a permanent influence on economic growth not only as a component of aggregate demand, but also through their indirect influence on the growth of TFP.

Table 21. Foreign direct investment in Poland

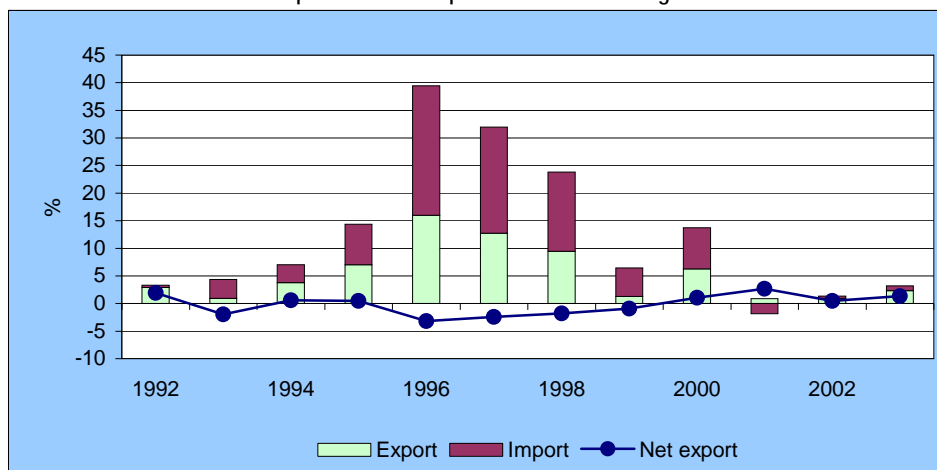
|                | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000  | 2001 | 2002 | 2003 |
|----------------|------|------|------|------|------|------|-------|------|------|------|
| in USD billion | 1.49 | 2.51 | 5.20 | 5.68 | 9.57 | 7.89 | 10.60 | 7.15 | 6.06 | 6.42 |
| as % of GDP    | 1.61 | 1.85 | 3.38 | 3.70 | 5.66 | 4.80 | 6.37  | 3.85 | 3.17 | 3.06 |

Source: Calculations of the Economic Analyses and Forecasting Department of the Ministry of Economy and Labour, on the basis of data from the PAIIZ and CSO.

## 2.6. Influence of export on the dynamics of the GDP

Under conditions of a permanent growth of consumption, and significant variances in the level of investment, caused by general economic situation, the net export constitutes a sort of moderator for the dynamics of economic growth. The reduction of gross fixed capital formation is compensated with improvement in net export. Such situation was seen in Poland during the period of economic slowdown, in 2001–2002. This is tied directly to high import consumption of investment, and also thane inflow of foreign savings. They finance the growth of investment outlays in a situation where the rate of domestic savings is low. At the same time, they contribute to the appreciation of the domestic currency. Appreciation of currency has a negative influence on the price competitiveness of export, resulting in a reduced influence of net export on economic growth.

Chart 6. Influence of net export and its components on economic growth.



Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.

Since 2000, net export has been showing positive influence on the economic growth. Such situation has already been present in 1992. In the following years, the dynamics of both export and import rose. As the dynamics of import was higher, the contribution of net export remained negative. In 2001, the contribution of import to growth was positive, which caused net export to become the basic factor influencing economic growth in Poland. This was coupled with a period of economic slowdown, and prevented recession. In 2003, export became more dynamic, and its contribution to the growth of GDP reached 2.1%. As import contribution amounted to 0.8%, net export accounted for 1.3% of GDP growth.

During the first quarter of 2004, the dynamics of both export and import was stable. In the subsequent quarters, we expect to see a stable growth of export and increased dynamics of import, tied to the expected growth of investment outlays. In 2005, we expect that the contribution of net export on economic growth will be negative.

The specific foreign exchange situation<sup>24</sup> in 2003 was a factor that boosted export and limited import, in a short-term perspective. A serious weakening of the USD (over 20%, in nominal terms) and of PLN (by over 14%) in relation to EUR – as the currency dominating the European common market, which absorbs almost 70% of the Polish export – constituted a strong export incentive not only for the already experienced exporters but also for entities which so far have not engaged in export activity, especially small and medium-sized enterprises. The opportunity of obtaining a certain exchange rate bonus, on the level of about 14% revenues on sales settled in EUR, put the exporters in a privileged position in relation to companies selling only in the domestic market. At the same time, it gave them a sufficiently wide profitability margin, and room for necessary price concessions while competing with foreign competitors, especially those from Western Europe.

Export orientation of these entities, supported by a positive exchange rate situation in 2003, would not have been possible without earlier preparations in the area of technology, organization, marketing etc. These preparations will allow to at least maintain the scope of export in 2004 and in the following years, even when foreign exchange situation becomes less favourable.

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<sup>24</sup> The reduced dynamics of import was the result of the downward trend in investment, which largely determine changes in import, as well as the directions and intensity of these changes.

## **2.7. Scientific research and development works (R&D)**

Due to the publishing cycle of the Central Statistical Office, the situation regarding the scientific research and development works, presented in this chapter, refers to 2002. Statistical data for 2003 was not available at the time of preparation of this chapter. Most of the statistical data presented here is derived from the study „Science and Technology in 2002”, CSO, Warsaw 2004.

### **Status of the R&D sector in Poland**

In 2002, Poland had 257 research and development entities: 139 science and research institutes, 10 central laboratories, 62 research and development centers, and 46 other research and development entities, classified by the CSO under the R&D sector. These entities had 32,533 employees. In 2002, 39.5% of these entities had a negative financial result; and 13% incurred financial losses in three subsequent years (2000–2002). As financing from the central budget is decreasing, most R&D entities have undertaken various measures to stay in the market. They have engaged in various forms of research and service activity<sup>25</sup>.

According to the status at 31 December 2003, the Minister of Economy, Labour and Social Policy supervised 119 R&D entities, including: 72 institutes, 43 research & development centers and 4 central laboratories, which together had about 18 thousand employees.

### **Restructuring of research and development entities**

The R&D entities constitute a sector of the economy where no significant structural changes, such as commercialization or privatization, have been made so far. In the period of economic transformation, the R&D entities have been forced to operate under market economy conditions – that is, other than those in which they have been founded. Some have lost their partners from the industry, or the direct buyers of their products and services. In consequence, the demand of these entities for funds from the state budget grew.

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<sup>25</sup> Data of the Central Statistical Office.

In 2003, an Inter-Ministerial team was established, to deal with issues of ownership transformation of research & development entities<sup>26</sup>. Its task was to analyse the sector of R&D entities and to prepare detailed directions for changes. The team prepared a final report on its operations and presented in it diagnosis of the situation and proposals for structural and ownership changes in this sector.

The proposals of the Inter-Ministerial Team are based on the assumption that the need to consolidate the R&D entities is urgent. This need results on one hand from the significant scattering of R&D activity, and on the other from the need to concentrate the scientific and research potential in selected or complimentary fields of technology, in order to create strong and effective entities, able to operate within the European Research Area.

The following actions should contribute to improvement of the current situation:

- reduction of the number of state R&D entities,
- reduction of the scattering and increase of the research potential of the entities, through various forms of their consolidation,
- change of the organizational and ownership structure, in line with the goals and tasks of the entities,
- enable the employees to become co-owners of the transformed entities.

Among the research and development entities supervised by the Minister of Economy, Labour and Social Policy, the following organizational changes occurred in 2003:

1. The process of liquidation of the R&C Center of Machine Tools and Special Devices in Poznań
2. The H. Niewodniczański Nuclear Physics Institute w in Cracow was transformed, on 1st September 2003, into the H. Niewodniczański Nuclear Physics Institute of the Polish Academy of Sciences.
3. The liquidation process of the following entities was ongoing:
  - the Centre for Research and Business Promotion „KORNO” in Łódź,
  - the R&D Centre of Soil and Transport Machines in Stalowa Wola,
  - the Plastics and Paints Industry Institute in Gliwice.

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<sup>26</sup> Decision 2/Org/2003 of the Minister of Economy, Labour and Social Policy, of 31 March 2003.

4. In 2003, liquidation of the following entities was commenced:
- the R&D Centre of the Air Conditioning, Ventilation and Dust Extracting Devices “Barowent” in Katowice,
  - the R&D Centre „Skarżysko” in Skarżysko-Kamienna.

#### Financing of the R&D sector

In 2002, financial outlays for the R&D activity were lower than in 2001. The absolute reduction in the amount of outlays was seen for the first time in many years. The share of these outlays in the GDP amounted to 0.59%, which also was the lowest value in years. In the developed countries, the share of outlays for R&D in the Gross Domestic Product is 3–4 times higher. Coupled with the much higher level of GDP this means that the outlays for R&D per capita are several times higher (Poland – USD 67, USA – USD 964, Sweden – USD 1,111).

In 2002, less budget funds and less money of enterprises was spent for R&D activity. Expenses from other sources rose, especially funds obtained from abroad – by 84%.

Table 22. The financing structure of the R&D sector

| Year | Total | Budget | Non-budget | of this:    |       | (3 : 2) % | (4 : 2) % |
|------|-------|--------|------------|-------------|-------|-----------|-----------|
|      |       |        |            | Enterprises | Other |           |           |
| 1    | 2     | 3      | 4          | 5           | 6     | 7         | 8         |
| 2001 | 4 858 | 3 147  | 1 711      | 1 181       | 530   | 64.8      | 35.2      |
| 2002 | 4 583 | 2 800  | 1 783      | 1 038       | 745   | 61.1      | 38.9      |
| %    | 94.3  | 89.0   | 104.2      | 87.9        | 140.6 | x         | x         |

Source: *Science and Technology in 2002, CSO.*

The structure of expenses is dominated by funds of the state budget. This structure is wrong. According to recent findings of experts from the European Union and the OECD, the optimum mix of non-budget and budget funds should be set at 65:35. Developed countries have the structure close to the desirable level. According to experts, if the share of non-budget funds is lower than 65%, the so-called global effectiveness of R&D outlays is reduced.

In 1994–2004, the share of budgetary funds for the research and development works was showing a downward tendency, from 0.55% in 1994 to 0.324% of the GDP in 2004 (on the basis of the budgetary law). This tendency is very



disturbing. The non-budget outlays for the financing of the R&D sector in 1994–2004 were on a relatively stable level and amounted to about 0.3% of the GDP.

The Lisbon Strategy posed new challenges for European science. It assumes that outlays for science would grow to reach the level of 3% of GDP in 2010. The document prepared by the Ministry of Science and Information Technology, in cooperation with the Ministry of Economy and Labour, „Strategy for increasing outlays for R&D activity in order to meet the assumptions of the Lisbon Strategy” states that it would require tripling the budget outlays, and increasing the non-budget outlays seven times.

Financial motivation instruments for entrepreneurs play a significant role here. They are meant to motivate the entrepreneurs to increase the outlays into research and development activity, to increase innovation with the transfer of new technologies from the area of science into the economy, and to increase the number of enterprises which offer products or services on the basis of new technological developments.

#### **Multi-annual programmes**

In 2003, Poland implemented one multi-annual programme of the R&D sector, „Adapting the working conditions in Poland to the standards of the European Union”.

In 2003, the following programmes were in the preparatory phase:

1. „Improving the systems for development of innovation in production and operation in 2004–2008”. The main goal of the programme is to create systemic conditions, as well technical and organizational innovative solutions in the area of advanced products and the technologies of production and operation. The main contractor and coordinator for the programme is the Institute for Terotechnology in Radom.
2. „Safety of the use of technical infrastructure, threatened with the results of corrosion”. The contractor and coordinator for the programme is the Institute of Precision Mechanics in Warsaw.
3. „Safety of the use of technical infrastructure, threatened with the results of corrosion”. The contractor and coordinator for the programme is the Institute of Precision Mechanics in Warsaw.

4. „The policy and energy safety of the state and management of the energy resources, taking into account the standards of the European Union and requirements tied to environment protection”. The contractor and coordinator for the programme is the Institute of Power Engineering in Warsaw.

#### **Target projects and contracted target projects**

The subject matter of target projects applies to applied research and development works, important for social or economic reasons, which together with the implementation and investment portion constitute an economic or social undertaking.

In 2003, the Ministry of Science and Information Technology registered 302 applications for civilian target projects. The Ministry signed 177 contracts for providing financial support for applied research and development works, for a total of 105 million zloty. In 2003, financial support amounted to PLN 32 million. In 2003, there had been 854 open contracts on civilian target projects, and PLN 115 million was spent on support for them.

In 2003, no new contracted target project was signed, but 30 contracts were active. Two of them applied to contracted target projects in the area of defense. A total of PLN 9 million was spent for financing of projects.

#### **Participation of R&D entities in the Sixth Framework Programme for Research and Technological Development of the European Union**

The year 2003 was the first year of the functioning of the Sixth Framework Programme for Research and Technological Development of the European Union (FP6).

Evaluation of Poland's participation in FP6 after the first competition should be analysed on the basis of average success rate (the relation between applications submitted and approved by the European Commission), which amounts to 13% (the EU average is 43%). The obtained results should be seen as poor. However, it is worth noting that Polish R&D entities were more interested in participation in FP6 than in a similar Fifth Framework Programme. The largest number of applications were filed under the NANO project (788 institutions) and IST (743 institutions).

In the opinion of the National Contact Point (NCP) of the FP6, the poor results are caused by a number of barriers, including:

- insufficient preparation of Polish research institutions to apply the new instruments under FP6,
- lack of interest among foreign partners (especially from large consortia) to include Polish research teams in the executed projects.

The NPC believes that the following actions should be undertaken:

- a) training of the potential programme participants in preparing applications and managing the project in line with the rules for new FP6 instruments,
- b) encouraging Polish entities to actively search for partners, and supporting their activity in that area.



## Chapter 3

# HOUSEHOLDS AND CONSUMPTION

### 3.1. Income of households

The overall gross disposable income of households consists of:

- 1) salaries of employees,
- 2) revenues of individuals managing business activity,
- 3) social insurance benefits,
- 4) income tied to ownership of assets,
- 5) taxes and
- 6) various transfers to and from households.

The two last items correct the volume of income listed under items 1) – 4).

During the period 1995-2002, the gross disposable incomes of households (calculated in current prices) rose from PLN 220.9 billion in 1995 to PLN 399.5 billion in 1998, PLN 509.1 billion in 2000 and PLN 559.8 billion in 2002<sup>27</sup>.

During that period, the relation of household incomes to the GDP was clearly stable, and remained on a level of about 72%. The structure of incomes underwent changes.

The share of individuals managing business activity, and the revenues tied to ownership of assets, was reduced in 1995–2002. This was due mainly to a slower economic growth and lowered profitability of enterprises.

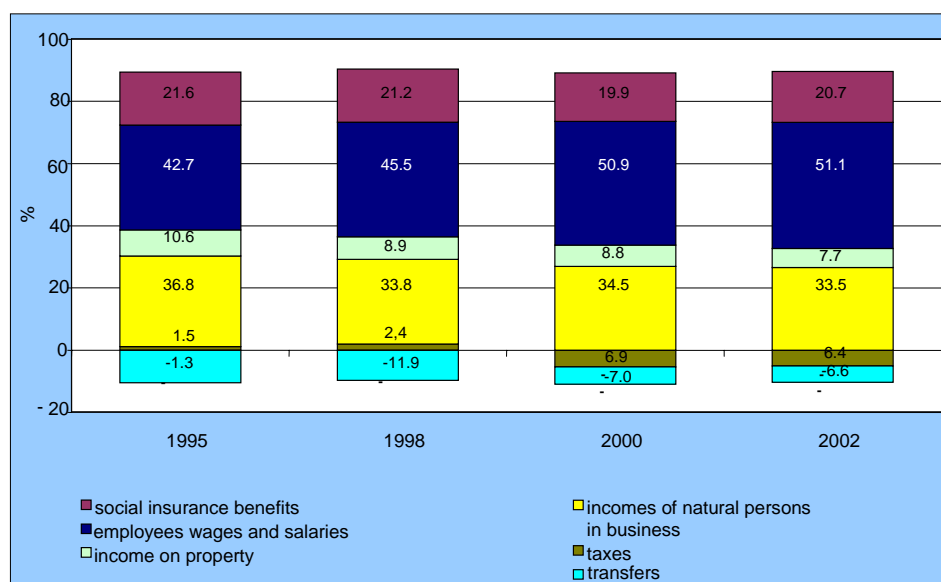
The share of social insurance benefits in revenues of households was relatively stable in 1995–1998; and was reduced after the changes introduced to the manner for calculating social security contributions. It has shown a growth tendency in 2000–2002.

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<sup>27</sup> In 2000 and 2002, the income was corrected by the change in net share of households in the reserves of pension funds.

The data from 2000–2002 is not fully comparable with data for the previous years. In 1999, changes were introduced in the manner for calculating social security contributions, which caused lack of continuity in the data on incomes, direct taxes and transfers.

Chart 7. The structure of gross disposable income of households in 1995, 1998, 2000 and 2002.



Source: National accounts according to institutional sectors and sub-sectors for the years 1995-2000 and 2000-2002. CSO and the Statistical Yearbook of Poland, 2003.

The role of taxes in reducing the disposable incomes of households was dwindling during the whole period. The influence of transfers on the household incomes was positive in 1995–1998. In 2000–2002 it became negative. This was caused by a move of some of the families' savings from the banks to investment funds and to open pension funds (OFE).

In 1996–2002, the growth rate of the effective gross disposable income of households was very varied. Since 1998, it has shown a clear downward trend: from 7.1% in 1997 to barely 0.8% in 2002.

No data is available on national accounts for 2003, but indirect information allows for the conclusion that the downward trend of income growth has been stopped. The growth rate of effective gross salaries in the national economy has picked up (by 4.1%, compared to 0.7% in 2002). The partial results of household budget research have shown that in 2003 the average monthly disposable income per 1 member in a family rose effectively by 1.6%, and disposable income by 1.7%<sup>28</sup>

<sup>28</sup> The situation of households in 2003, in the view of results of research of household budgets. CSO, Department of Social Statistics. Current information. Material for press conference held on 23 June 2004.

The growth rate of effective incomes varies strongly across the individual groups (subsectors) of households. The largest growth of income is achieved by households other than households of individual farmers. A serious reduction of effective income was found in the sector of employees, and self-employed individual farmers.

Table 23. Dynamics of effective gross disposable income of households in 1996–2002

| Description   | 1996  | 1997  | 1998  | 1999  | 2000  | 2001  | 2002  | Average annual growth rate in: |           |           |
|---|-------|-------|-------|-------|-------|-------|-------|--------------------------------|-----------|-----------|
|   |       |       |       |       |       |       |       | 1996–2000                      | 2001–2002 | 1996–2002 |
| Effective gross disposable income <sup>x)</sup><br>– overall                            | 104.8 | 107.1 | 104.6 | 102.0 | 101.4 | 101.3 | 100.8 | 3.9                            | 1.0       | 3.1       |
| of this:  |       |       |       |       |       |       |       |                                |           |           |
| – employers and self-employed individual farmers  | 90.9  | 91.7  | 91.0  | 75.8  | 87.4  | 105.7 | 91.7  | -12.9                          | -1.6      | -12.0     |
| – outside individual farms in agriculture   | 104.9 | 110.2 | 106.3 | 103.5 | 103.9 | 101.2 | 101.0 | 5.7                            | 1.1       | 4.4       |
| – in the sub-sector of individuals:   |       |       |       |       |       |       |       |                                |           |           |
| – hired workers   | 107.4 | 107.0 | 104.8 | 100.9 | 99.8  | 100.5 | 100.6 | 3.9                            | 0.5       | 2.9       |
| – persons with non-salaried sources of revenue  | 103.4 | 106.0 | 104.2 | 106.2 | 102.3 | -     | -     | 3.9                            | -         | -         |
| – persons receiving disability and retirement pensions                                  | x     | x     | x     | x     | x     | 102.3 | 102.1 | -                              | 2.1       | -         |
| – persons for whom the non-salaried source of revenue is the main source of subsistence | x     | x     | x     | x     | x     | 102.2 | 105.8 | -                              | 4.0       | -         |
| – other   | x     | x     | x     | x     | x     | 104.7 | 103.3 | -                              | 4.0       | -         |

<sup>x)</sup> where the Consumer Price Index is used as deflator.

Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.

According to estimates for 2003, most probably a decrease of effective income was recorded in the subsectors of employers and self-employed individual farmers. The results of household income research show that while the average monthly effective disposable income per 1 family member rose by 1.7%, the

income of a farmer dropped by 17.8%. At the same time, the average effective income of hired workers rose by 3.7%; income of employees using farms rose by 1.5%; of self-employed persons by 1.1%, of retirees by 1.8% and of persons collecting disability pensions by 2.4%.

### 3.2. Consumption and savings

In 1996–2002, the nominal expenses of households for consumption rose on the average by 15.1% annually. The increase reached 22.2% in the period 1996–2000; and 6.2% in 2001–2002. The growth of expenses was the lowest in 2002, amounting to only 5.2%.

Table 24. The nominal and effective increases in expenses for consumption and in savings of the household sector in 1995–2002

| Description  | 1995  | 1998  | 2000  |       | 2002  | Average annual growth rate in the in: (%) |           |           |
|--|-------|-------|-------|-------|-------|---|-----------|-----------|
|  |       |       | A     | B     |       | 1996–2000                                 | 2001–2002 | 1996–2002 |
| 1. Nominal consumption expenses of households, in PLN billion                                | 185.6 | 346.9 | 440.5 | 447.5 | 504.0 | 22.2                                      | 6.2       | 15.1      |
| 2. Gross savings in PLN billion  | 35.3  | 52.6  | 55.4  | 61.8  | 55.8  | 9.4                                       | -4.4      | 8.2       |
| 3. Gross accumulation in PLN billion   | 12.5  | 22.3  | 28.2  | 33.2  | 36.2  | 17.7                                      | 4.4       | 13.7      |
| 4. Gross liabilities in PLN billion  | 22.8  | 30.2  | 27.2  | 28.6  | 19.6  | 3.6                                       | -17.2     | -2.9      |
| 5. Effective increase of consumption expenses of households <sup>x)</sup> in %               | 3.6   | 4.6   | 2.5   | 2.5   | 3.2   | 5.5                                       | 2.3       | 4.6       |
| 6. Share of nominal consumption expenses in the gross disposable income of households – in % | 84.0  | 86.6  | 88.8  | 87.9  | 90.0  | 4.8                                       | 2.1       | 6.9       |
| 7. Gross savings rate <sup>xx)</sup>   | 16.0  | 13.2  | 11.2  | 12.1  | 10.0  | -4.8                                      | -2.1      | -6.9      |
| 8. Accumulation rate <sup>xx)</sup>  | 5.7   | 5.6   | 5.7   | 6.5   | 6.5   | 0   | 0         | 0         |
| 9. Net liabilities rate <sup>xx)</sup>   | 10.3  | 7.6   | 5.5   | 5.6   | 3.5   | -4.8                                      | -2.1      | -6.9      |

<sup>x)</sup> deflated with the Consumer Price Index.

<sup>xx)</sup> compared to the gross disposable income of households.

A – in conditions comparable to the preceeding years, B – in conditions comparable to the following years.

Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.



The effective consumption of households rose on the average by 3.1% annually in the period 1996–2002. In 1996–2000 the increase amounted to 3.9%, and to 1.0% in the period 2001–2002. The lowest increase – of 0.8% – was recorded in 2002.

In 2003, an increase in effective expenses of households accelerated. Research of household budgets revealed that the average monthly expenses per 1 person in a household rose effectively by 2.2%, compared to the previous year. Increase of expenses was registered in all socio-economic groups of households, with the exception of farmers.

In 1996–2002, the average annual effective increase of consumption expenses of households reached 4.6%, and was much higher than the average effective increase of their gross disposable income, which amounted to 3.1%. During the whole period, the share of consumption expenses in the incomes of households kept on rising. In comparable conditions, this share rose from 84.0% to 88.8% in 1995–2000; and from 87.9% to 90% in 2000–2002. The rate of gross savings of households was thus reduced, respectively, from 16.0% to 11.2% and from 12.1% to 10%. As the rate of gross accumulation was identical during both analysed periods, the rate of net liabilities of households went down.

This means that a higher increase of consumption expenses than the incomes of households in 1996–2002 was achieved by a reduction of the rates of their gross savings and net liabilities.

The difference in effective increases in 2003 of the average monthly income (1.7%) and the expenses (2.2%) of households per 1 member means that the rate of gross savings of households continued to drop further.

### **3.3. Durable consumer goods, owned by households**

In 2003, equipment of households with durable consumer goods improved further. This applied in particular to goods, which satisfy higher level of needs. The radio and television equipment purchased by families included primarily CD players, video cameras and hi-fi sets; while dishwashers and microwave ovens

were the most frequently bought household appliances. The numbers were also higher in the case of color TV sets, bicycles used mainly for recreational purposes, and cars.

In statistical terms, each of the households researched in 2003 had at least one color TV set (only less than 3% of families reported not having this comfort), every second family had a video player and a device enabling the receipt of cable or satellite television. Almost every second family had a mobile telephone; and 45% of households had a hi-fi set. Less than 30% of households owned PCs, of that 14% had also Internet access. About one-fourth of families (26.6%) had a microwave oven. Almost half of households (48.9%) owns a car, and 65% had at least one bicycle. A relatively small percentage of households owned a video camera (5.4%) and a dishwasher (3.4%) in 2003. This number is growing every year.

The level of durable consumer goods owned by families varies strongly across the various socio-economic groups. Most of durable goods – especially the so-called comforts, which satisfy higher level of needs – are found in self-employed families, which also achieve the highest income per one family member.

There still exists a clear and strong relationship between the level of income obtained by a given type of household and the level of equipment with durable consumer goods. For example, in the households of employees, among 20% of persons with the highest incomes (V quintile group) there were 9 times more dishwashers, almost 8 times more video cameras, 3 times more computers and printers, almost 2 times more mobile phones and CD players, as well as 2 times more cars and microwave ovens than in the group of 20% persons with the lowest incomes (I quintile group).

In the households of retirees and persons collecting disability pensions, this variance was less pronounced and applied to a much smaller groups of goods. The wealthiest families of retirees and pensioners had almost 6 times more video cameras, 3 times more dishwashers and almost 2 times more satellite TV receivers than the families with the lowest incomes. In the case of automatic washers and microwave ovens, the difference reached 1.3 – 1.4 times.

### **3.4. Income inequalities**

The average nominal disposable<sup>29</sup> income per 1 person in all households amounted to PLN 680.50 in 2003. The highest level of income was achieved by self-employed families (26.4% higher than the average income in all households). Higher than average incomes were also achieved by families of retirees (by 19.7%) and employees (by 7.3%).

The average monthly disposable income per 1 person in the other groups of families was lower than the income in all households (in the case of farmers, by 30.3%; employees using farms by 23.4% and pensioners by 17.3%).

The variance in the level of nominal gross disposable income per 1 person among the socio-economic groups of households is largely caused by the differences in the size and composition of these households. The individual groups of households are characterized by varied average number of persons in one household. In 2003, the average number of persons per household amounted to 3.1. In the individual groups of families, this number varied – from 4.6 persons in the families of employees using farms to 2.2 persons in families of retirees.

The average monthly disposable income per 1 person in household depends on the number of persons in the given household. The larger the number of persons in a family, the lower is, as a general rule, the average monthly income per 1 family member. In 2002, when the average monthly disposable income per 1 family member amounted to PLN 664.21, income higher than the average was found in: single-person families (by 65.5%), two-person families (44.6%) and three-person ones (by 16.2%); while lower income was registered in: 4-person households (by 9.6%), 5-person households (by 28.9%); and in families with 6 or more members (by 40%).

The presentation of average levels of disposable incomes in the various socio-economic groups does not reflect the differences in the income situation within the groups of families. The research shows that in 2003,

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<sup>29</sup> This income differs from the actual disposable income of households by the amount of the so-called other expenses – expenses other than consumer goods and services. In 2003, the other expenses constituted 4% of the average nominal expenses of households per 1 person; and 3.8% of the average disposable income of household per capita.

among all households, the average monthly disposable income of 20% of the persons with the highest income levels (V quintile group) amounted to PLN 1,455 per person and was almost 6 times higher from the average income of the 20% of persons with the lowest income (I quintile group). Compared to the previous year, the diversity in overall incomes of households did not change significantly.

No significant changes were found in the diversity in income of the two most frequently found socio-economic groups of Polish households: in the families of employees and of retirees and pensioners, measured jointly.

In the families of employees, in 2003 the average monthly disposable income reached PLN 1,552 per person among the 20% wealthiest families, and was 5.4 times higher than income per person in the 20% poorest families (in 2002, the difference amounted to 5.3 times). In the households of retirees and pensioners, the diversity in income levels in 2003 was smaller than in the case of the employees. The average monthly disposable income reached PLN 1,347 zloty per person among the 20% wealthiest households, and was 4.4 times higher than income per person in the 20% poorest families – just as in 2002.

Among all households, in 2003 the 20% of families with the best income situation controlled – just as a year earlier – about 41% of the total income of all researched households; while the 20% of persons in the worst financial situation accounted for only 7% of the total income.

The spread of employees' incomes in 2003 shows that 20% of the wealthiest persons controlled 40.4% of the total income of that group of families; while 20% of the poorest families accounted for 8.1% of the income (in 2002, these values amounted to 39.9% and 8.2%, respectively). In the households of retirees and pensioners, the same ratios in 2003 amounted to 35.5% and 8.8% (35.4% and 8.6%, respectively, in 2002).

The higher effective increase of incomes and expenses of households in 2003 served to improve the subjective evaluation of their financial situation. Compared to 2002, the proportion of families which perceived their financial situation as bad and rather bad fell (from 36.1% to 34.6% – by 1.5 percentage point); while the numbers rose among families which described it as average (from 52.0% to 52.6%), and at least good (from 11.9% to 12.8%).

Table 25. The scope of poverty in Poland in 1996–2003

| Poverty thresholds                | 1996   | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|-----------------------------------|--|------|------|------|------|------|------|------|
|                                   | percentage of persons living below poverty threshold |      |      |      |      |      |      |      |
| Relative <sup>1)</sup>            | 14.0   | 15.3 | 15.8 | 16.5 | 17.1 | 17.0 | 18.4 | 19.7 |
| Statutory <sup>2)</sup>           | -  | 13.3 | 12.1 | 14.4 | 13.6 | 15.0 | 18.5 | 19.2 |
| Existence minimum <sup>3)</sup>   | 4.3  | 5.4  | 5.6  | 6.9  | 8.1  | 9.5  | 11.1 | 11.7 |
| Subjective (Leyden) <sup>4)</sup> | 30.5   | 30.8 | 30.8 | 34.8 | 34.4 | 32.4 | 30.4 | 26.7 |

1) 50% of the average monthly expenses of households

2) The amount which, according to the law, is the entitlement level for social assistance benefits

3) Estimated by the Institute of Labor and Social Studies – takes into account only those needs, whose satisfaction cannot be postponed, and consumption lower from that level leads to biological depletion

4) Percentage of households in the fourth quarter

Source: data of the Central Statistical Office.

An improvement of opinion was seen in households of employees (an increase by 1.9 percentage point of more than average evaluations), employees using farms (an increase by 0.7 percentage point); and retirees and pensioners (0.5 percentage point increase). The evaluation became worse among farmers and self-employed persons (the negative opinions rose by 2.3 and 1.2 percentage point, respectively).

At the same time, as strong diversity remained between the various socio-economic groups of households, and especially within these groups between the extreme quintiles, in 2003 we saw a continuation of the tendency of growth in objective poverty, observed for a number of years. This poverty level is calculated on the basis of research of household income.

This means that in 2003 the scope of relative poverty rose to 19.7%, compared to 18.4% in 2002. The percentage of persons living in families where the level of expenses was lower than the so-called statutory poverty level amounted to over 19% (in 2002 – 18.5%). The scope of extreme poverty – whose threshold is defined as minimum existence level – was estimated in 2003 at 11.7%, compared to 11.1% in 2002.

The percentage of households, whose level of income was lower than the subjective poverty limits, estimated according to the Leyden method, was reduced to about 27% at the end of 2003 (from about 30% at the end of 2002). Most probably, the main reason for this change was the increase in effective income of households.

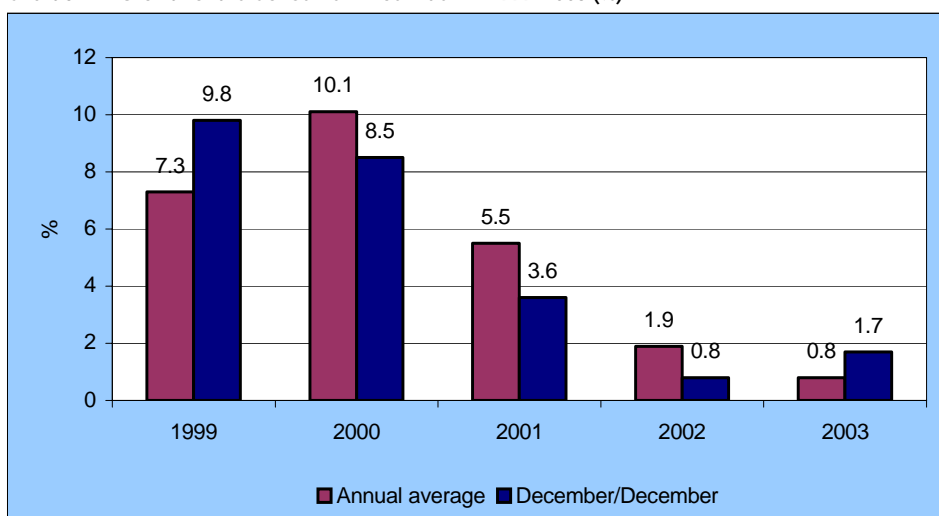


## Chapter 4

# INFLATION

In the 1990's, one of the main tasks of monetary policy was to reduce inflation. The changes in prime interest rates of the National Bank of Poland were used to implement this goal. Despite the various assessments of the levels of interest rates and the activities of the Monetary Policy Council, inflation was reduced – although during some years the decrease was a bit slower than in other countries of Central Europe.

Chart 8. Growth of the Consumer Price Index in 1999–2003 (%)



Source: Statistical Bulletins of the Central Statistical Office.

In 2003, despite acceleration of the economic growth, inflationary pressure was very low, because of the situation on the labor market. High unemployment rate and fear of losing jobs did not encourage workers to put pressure on wage increase. In such circumstances, the annual average inflation was further reduced, and reached its lowest level since the start of the transformation period. However, it should be pointed out that every subsequent quarter brought a grad-

ual change in the inflation trend, as the product gap closing. As a result, the CPI<sup>30</sup> inflation reached a level higher than its 2002 result.

The situation was a little different in the case of prices of sold industrial output. Here the reversal of the inflation trend was seen the earliest. The rising demand for industrial output caused a dynamic increase of that production (more than twice higher from GDP growth), accompanied with a faster price dynamics. As a result, prices of industrial production – both the annual average and PPI measured December to December – rose faster than in 2002.

The acceleration of economic growth in 2003 occurred under the situation of decreasing gross outlays on fixed assets. This reflected on the situation in the construction sector, as it services the investment processes. The demand for construction and assembly production dropped, which caused a decline in the production itself, and its prices. The prices of construction and assembly production – both the annual average and measured December to December – were in consequence lower than in 2002.

## **4.1. Consumer Price Index**

The average annual growth of the Consumer Price Index in 2003 reached 0.8% and was lower both from the index written into the budget law (2.3%), and from its value achieved in the previous year (1.9%). The increase of prices in 2003 was slower than during the previous year, by 1.1 percentage point. The largest increase was registered in the prices of transport, goods and services tied to housing and energy carriers. A relatively high increase of prices was recorded in the health, education and leisure and culture sections. A significant acceleration of price increases was registered in the transport section; and was caused by the increase in fuel prices (7.9%) and the prices of railway transport services (5.9%). The prices of food, non-alcoholic beverages, alcohol, tobacco, clothing and shoes dropped.

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<sup>30</sup> Increases of the prices of consumer goods and services, compared to the same month of the previous year. In this specific case, December 2003 to December 2002.



Measured December to December prices rose by 1.7%. The faster growth of prices, compared to 2002, was due mainly to the significantly faster dynamics of the prices of food and non-alcoholic beverages, alcohol and tobacco goods. The price dynamics was reduced in the remaining groups of goods and services. The fastest increase was registered in the prices of goods and services tied to housing and energy carriers. Prices fell in only two groups of products (clothing and shoes, other goods and services).

Table 26. Changes of the Consumer Price Index (%)

|  | year/ year    |               |                 | December/ December |               |                 |
|--|---------------|---------------|-----------------|--------------------|---------------|-----------------|
|  | 2002/<br>2001 | 2003/<br>2002 | Change<br>(3-2) | 2002/<br>2001      | 2003/<br>2002 | Change<br>(6-5) |
| 1  | 2             | 3             | 4               | 5                  | 6             | 7               |
| Consumer goods and services                | 1.9           | 0.8           | - 1.1           | 0.8                | 1.7           | 0.9             |
| – food and non-alcoholic beverages         | - 0.7         | - 1.0         | - 0.3           | - 2.7              | 2.1           | 4.8             |
| – alcoholic beverages and tobacco products | 2.3           | - 2.2         | - 4.5           | - 3.1              | 2.1           | 5.2             |
| – clothing and shoes                       | - 0.8         | - 2.5         | - 1.7           | - 1.2              | - 3.3         | - 2.1           |
| – use of housing and energy carriers       | 5.9           | 3.3           | - 2.6           | 4.7                | 3.3           | - 1.4           |
| – home equipment and household management  | 1.9           | 0.5           | - 1.4           | 0.9                | 0.4           | - 0.5           |
| – health                                   | 4.7           | 2.1           | - 2.6           | 3.7                | 1.9           | - 1.8           |
| – transport                                | 1.1           | 4.5           | 3.4             | 5.0                | 2.9           | - 2.1           |
| – communication                            | - 0.1         | 0.0           | 0.1             | 0.0                | 0.0           | 0.0             |
| – leisure and culture                      | 2.5           | 1.8           | - 0.7           | 2.1                | 1.7           | - 0.4           |
| – education                                | 4.1           | 2.3           | - 1.8           | 2.5                | 2.1           | - 0.4           |
| – hotels and restaurants                   | 2.9           | 1.2           | - 1.7           | 1.9                | 1.1           | - 0.8           |
| – other goods and services                 | 2.9           | 0.1           | - 2.8           | 1.5                | - 1.3         | - 2.8           |

Source: Statistical Yearbook of the Central Statistical Office, March 2004.

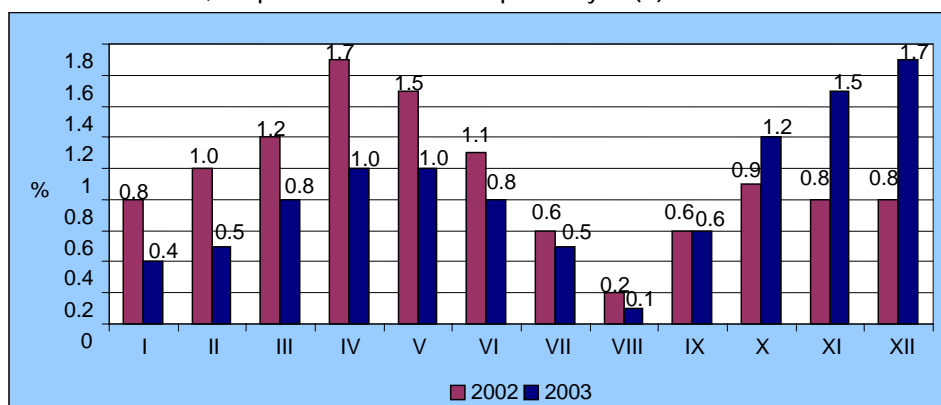
During the last four months of 2003, the dynamics of prices picked up significantly. This was caused mainly by higher prices of food, caused by reduction in agriculture production.

The National Bank of Poland calculates the so-called base inflation, eliminating from the CPI index (increase in prices of consumer goods and services in individual months, compared to situation a year earlier) certain groups of consumer goods and services, such as controlled prices, prices of food or fuels.

In the first months of 2003 the base inflation index, after exclusion of controlled prices, has shown decreases by as much as 0.6%. This proves the inflationary nature of these prices. The base inflation rate, minus the prices of food

and fuels (net inflation), was higher than the CPI in the first half of 2003. In the second half of the year, this tendency started to turn around, and in the last months of the year the base inflation was lower than the CPI index. This proves that the dynamics of food prices picked up in the last months of 2003.

Chart 9. Increases of the prices of consumer goods and services in individual months of 2002 and 2003, compared to December of the previous year (%)



Source: Statistical Yearbook of the Central Statistical Office, March 2004.

Table 27. The CPI rate and base inflation rate in 2003

| Months | 1    | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9   | 10  | 11  | 12  |
|--------|------|------|------|------|------|------|------|------|-----|-----|-----|-----|
| CPI    | 0.5  | 0.5  | 0.6  | 0.3  | 0.4  | 0.8  | 0.8  | 0.7  | 0.9 | 1.3 | 1.6 | 1.7 |
| A      | -0.3 | -0.5 | -0.6 | -0.6 | -0.3 | 0.4  | 0.7  | 0.5  | 0.8 | 1.0 | 1.4 | 1.5 |
| B      | 0.5  | 0.5  | 0.5  | 0.0  | -0.1 | -0.1 | 0.0  | 0.1  | 0.3 | 0.7 | 1.0 | 1.1 |
| C      | 0.1  | -0.1 | -0.2 | -0.5 | -0.5 | -0.3 | -0.3 | -0.2 | 0.0 | 0.6 | 0.8 | 1.0 |
| D      | 1.6  | 1.5  | 1.4  | 1.2  | 1.2  | 1.1  | 0.8  | 0.8  | 0.9 | 1.2 | 1.3 | 1.3 |
| E      | 1.0  | 0.8  | 0.8  | 0.6  | 0.8  | 0.9  | 1.0  | 1.0  | 1.2 | 1.2 | 1.4 | 1.5 |

Source: Report on inflation in 2003, National Bank of Poland, Warsaw, March 2004.

Explanation of symbols in the left column of the table:

A – controlled prices (prices regulated indirectly with the rates of excise duty, such as: alcohol, tobacco, fuels; prices approved by relevant bodies – such as electricity, gas, central heating; uniform prices in the whole country, such as State Railway, postal services; prices and fees set by local authorities, such as local transportation)

B – prices with the highest variability (such as prices of eggs, fruit, electricity, fees tied to housing)

C – prices with the highest variability and prices of fuels

D – prices of food and fuels (net inflation)

E – 15% average cut (symmetrical cuts of 15% on the left and right sides of the spread of prices of the highest and lowest dynamics)

## 4.2. Prices of industrial output and of the construction and assembly production

The average annual prices of sold industrial output (Producer Price Index) rose faster than in 2002. This was caused by a significant acceleration of prices in the production activity sector.

The largest increases of prices were recorded in the production of coke and petroleum products (by 14.1%), production of metals (7.7%) and production of vehicles, trailers and truck-tractors (3.6%).

Table 28. Change of prices in industry and construction (%)

|                                      | year / year   |               |                 | December / December |               |                 |
|--------------------------------------|---------------|---------------|-----------------|---------------------|---------------|-----------------|
|                                      | 2002/<br>2001 | 2003/<br>2002 | Change<br>(3-2) | 2002/<br>2001       | 2003/<br>2002 | Change<br>(6-5) |
| 1                                    | 2             | 3             | 4               | 5                   | 6             | 7               |
| Sold industrial output               | 1.0           | 2.6           | 1.6             | 2.2                 | 3.7           | 1.5             |
| Mining and quarrying                 | 3.0           | 3.0           | 0.0             | 3.6                 | 7.2           | 3.6             |
| Production activity                  | - 0.1         | 2.4           | 2.5             | 1.4                 | 3.6           | 2.2             |
| Electricity, gas and water supply    | 7.0           | 4.6           | - 2.4           | 6.8                 | 3.3           | - 3.5           |
| Construction and assembly production | 1.2           | - 1.1         | - 2.3           | 0.4                 | - 1.4         | - 1.8           |

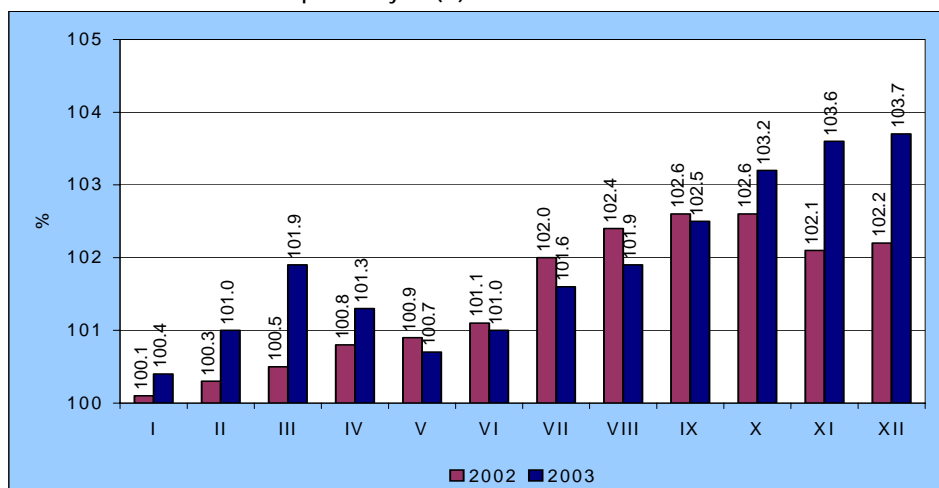
Source: Statistical Yearbook of the Central Statistical Office, March 2004.

Measured December to December, prices of sold industrial output rose by 3.7%.

The average annual prices of construction and assembly production dropped by about 1.1%.

Measured December to December, the prices of construction and assembly production dropped by 1.4%.

Chart 10. Dynamics of the Producer Price Index in individual months of 2002 and 2003, compared to December of the previous year (%)



Source: Statistical Bulletin of the Central Statistical Office, March 2004.

## Chapter 5

# STRUCTURAL ISSUES OF THE ECONOMY

## 5.1. The role of the private sector

The process of creating market economy – after over 40 years of the centrally planned system, which was characterised by domination of the public sector – required radical changes in the ownership structure of the economy. The structural changes, whose goal was to reverse the proportions of ownership, were one of the primary tasks of systemic transformation. Changes were introduced through:

1. privatization of state-owned enterprises,
2. creation of new, privately owned business entities.

The purpose of privatization of state-owned enterprises was (and still is) an improvement of effectiveness and competitiveness of the privatised entities. Privatization processes were usually preceded by financial and organizational restructuring, and technological modernization. Parallel to the privatization processes, new private businesses were created. Their number rose from 1.9 million at the end of 1993 to 3.5 million at the end of 2003. The share of private entities in the total number of business entities amounted to 96.4%.

Table 29. Share of the private sector in total gross value added, in industry and some sections in the years 1995–2002, and in the number of employed in the national economy (%)

|  | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002  |
|--|------|------|------|------|------|------|------|-------|
| Gross value added, total                 | 60.6 | 62.8 | 67.2 | 69.4 | 70.4 | 70.0 | 71.7 | 71.8  |
| Industry                                 | 44.6 | 49.8 | 60.0 | 63.4 | 65.5 | 68.8 | 71.9 | 70.7  |
| Construction                             | 90.3 | 90.7 | 94.8 | 95.5 | 96.4 | 96.2 | 96.1 | 96.2  |
| Commerce and repairs                     | 97.1 | 96.1 | 97.2 | 97.7 | 98.1 | 98.4 | 98.6 | 98.9  |
| Transport, warehousing and communication | 35.8 | 36.4 | 38.9 | 39.4 | 43.7 | 47.5 | 66.1 | 67.4  |
| Number of employed                       | 61.4 | 63.6 | 66.7 | 69.2 | 70.9 | 72.1 | 73.1 | 69.5* |

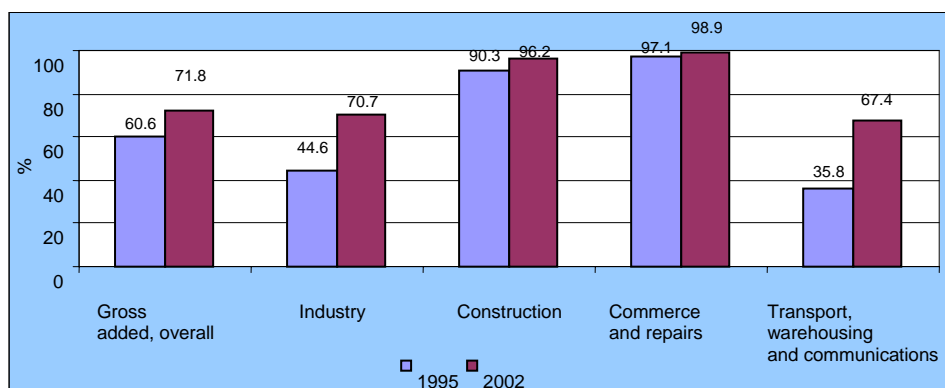
\* since 2002 on the basis of National Census of Population and Residential Units and the Agrarian Census, in 2003 the share of private sector reached 70.2%

Sources: Statistical Yearbooks of the CSO.

As a result of ownership changes, the share of the private sector in the economy has been rising successively. In the second half of the 1990's, this sector has gained a dominant position.

In terms of gross value added and in the number of employees, the share of the private sector has exceeded 70% for several years now. Even in mid-1990's, more than half of the gross value added in industry, transport, warehousing and communication was generated by the public sector. In 2002, even in those areas of activity the share of the private sector constituted about 70%. The construction and commerce sectors became dominated by private owners much earlier.

Chart 11. The share of the private sector in gross value added overall, in industry and selected sections in 1995 and 2002



Source: Statistical Yearbooks and Statistical Bulletins of the CSO.

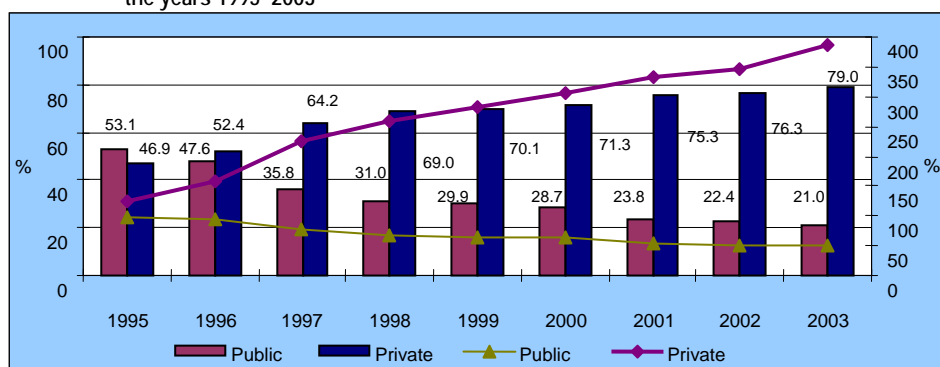
In 1995, the public sector participated in over 50% of the total sold industrial output. The dynamic increase of production in the private sector, and the downward trend in the public sector, caused a complete reversal of these proportions. In 2003, the participation of the private sector came close to 80%.

Since 1994, sold industrial output increased in the private sector almost four times, and in the public sector was reduced by half.

The decrease in industrial output of the public sector, which occurred in the course of transformation, was caused by two reasons:

1. privatization processes, which cause enterprises of the public sector to "move" to the private one,
2. limitation of production in some sectors or in enterprises of the public sector (such as hard coal mining).

Chart 12. Dynamics (lines) and structure (columns) of industrial output per ownership sector, in the years 1995–2003\*



\* dynamics in fixed prices (1994 = 100), structure in current prices

Source: Statistical Yearbooks and Statistical Bulletins of the CSO.

Table 30. Dynamics of sold industrial output in ownership sectors and the share of the private sector in sold output of industry in the years 1995–2003\* (%)

|  | 1995  | 1996  | 1997  | 1998  | 1999  | 2000  | 2001  | 2002  | 2003  |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Dynamics of sold industrial output                 | 110.2 | 108.8 | 111.2 | 104.8 | 104.4 | 107.1 | 100.0 | 101.5 | 108.7 |
| – public sector                                    | 98.7  | 96.2  | 81.8  | 87.5  | 94.5  | 101.5 | 81.9  | 92.4  | 99.5  |
| – private sector                                   | 126.0 | 126.0 | 141.3 | 115.0 | 108.9 | 109.4 | 107.9 | 104.6 | 111.5 |
| Share of private sector in sold output of industry | 46.9  | 52.4  | 64.2  | 69.0  | 70.1  | 71.3  | 75.3  | 76.3  | 79.0  |

\* dynamics in fixed prices (previous year = 100), structure in current prices, data for 2003 refers to entities with more than 9 employees

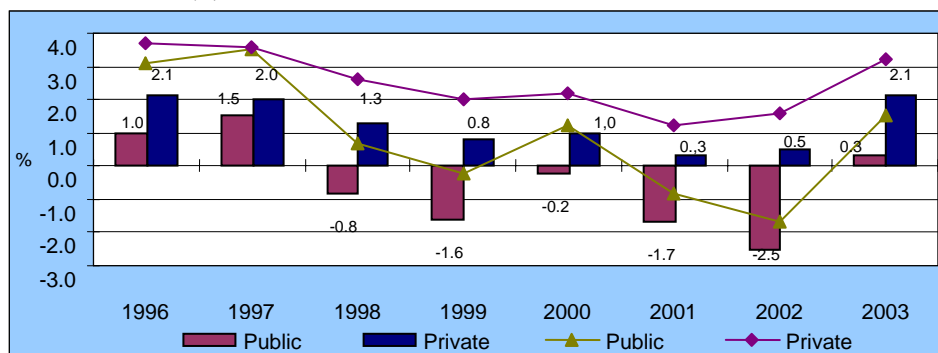
Source: Statistical Yearbooks of the CSO, Statistical Bulletins of the CSO.

The private sector dominates the turnover in foreign trade, and its participation in import is larger than in export. We should consider as positive the fact that the difference between share in import and in export gets smaller with time.

In transport and warehousing, and in investments, the share of the private sector is dominant, but relatively smaller than in other areas. However, in the case of transport, the main factor is that Polish State Railways (PKP) are still included in the public sector. In case of investments, the situation is due to the not very good financial standing of private enterprises, lack of domestic capital and problems encountered in the acquisition of external funds. Activities of the government, targeted at increasing the scope of public assistance in financing of investment projects, as well as accession to the European Union and the resulting larger inflow of assistance funds, should result in increased share of the private sector in investments.

The share of the private sector in the revenues on overall activity constituted 77.0% in 2003. This sector achieves also much better financial results.

Chart 13. Profitability gross (lines) and net (columns) in ownership sectors in the years 1996–2003\* (%)



\* in entities with more than 50 employees until 1999, and with more than 49 employees starting from 2000

Source: Statistical Bulletins of the CSO.

One of the measures of management effectiveness is profitability. The indices of gross and net profitability are more favourable in the private sector<sup>31</sup>, which proves that management in that sector is more effective.

Despite significant achievements in the field of increasing the role of the private sector in the economy, the privatization process is not complete yet. Whole sectors of the industry still wait to be privatized, such as hard coal mining, energy, defense industry and the Polish State Railways (PKP). Their privatization would lead to an ownership structure similar to the one found in developed countries, where the private sector accounts for 85% of the economy.

Privatization is not a goal in itself. It must be supported by other activities. Such activities include consolidation of business entities, increase of the scope of public assistance in the financing of business activity, increased inflow of foreign investment, and also implementation of the Lisbon Strategy. The purpose of consolidation of businesses is to increase their economic strength – effectiveness and competitiveness. Lack of domestic capital makes broad scope of business financing impossible, especially financing of development nature

<sup>31</sup> In 2003, a significant improvement of profitability in the public sector occurred. It was largely due to the process of reduction of the hard coal mining sector.



(investment and innovations). Increased scope of public assistance, tied to Poland's accession to the European Union, and the inflow of foreign capital, should enable the financing of development activity on a much broader basis. This will contribute to increasing the effectiveness and competitiveness of the economy. Implementation of the Lisbon Strategy provisions (increasing the share of R&D expenses to 3% of the GDP in 2010) should bring increased innovations in the economy. This in turn should lead to higher effectiveness and competitiveness. The actions named above are discussed in more detail in other chapters of this report.

Further strengthening of the role of the private sector should lead to better effectiveness and competitiveness of the economy; and to acceleration and stability of the economic growth rate. As a result, the distance separating Polish economy from economically developed countries will be gradually reduced.

## **5.2. Development of small business<sup>32</sup>**

### **The meaning of the SMEs sector**

One of the characteristic features of the social, political and economic changes in Poland is the **dynamic growth** of the sector of small and medium-sized enterprises (SMEs). The factor which stimulates the development of small and medium-sized enterprises was also the re-activation of the local authorities, which were interested in the economic development of their municipalities; as well as the new systemic solutions. The economic policy of the state, supporting the development of this sector, also brings positive results.

### **Enterprise development**

At the end of 2002, the REGON registry (national statistical registry of enterprises) included almost 3.5 million of business entities, entered in the relevant

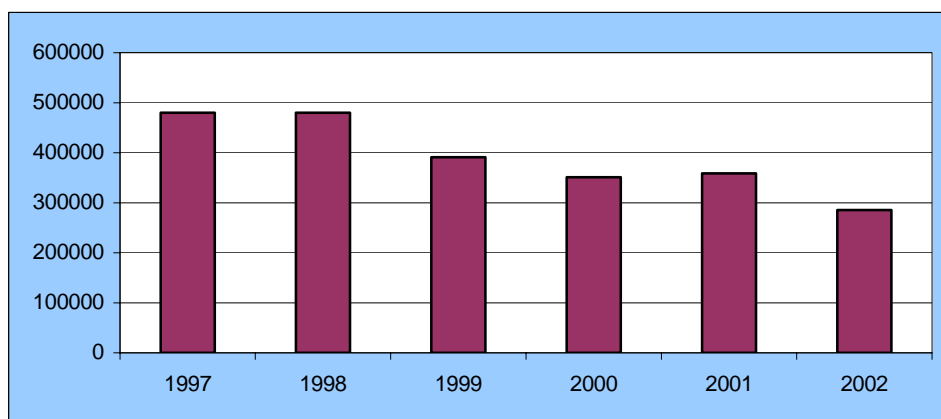
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<sup>32</sup> This chapter was based primarily on materials obtained from the Polish Agency for Enterprise Development, including the „Report on the condition of the sector of small and medium-sized enterprises in Poland in 2002–2003”. This chapter presents data that was the most up to date at the moment it was written.

sections of the Polish Classification of Business Activity (the sections of agriculture, forestry, fishery and public administration were not taken into account). Of this total number, about 3.4 million entities were from the private sector. The number of registered private entities was higher by 4.2% than in 2001.

In 2002, 271.4 thousand of new private entities were registered. It was by 20.4% less than a year earlier. The year 2002 saw a clearly slower dynamics of new business registration. This is a very negative occurrence from the standpoint of economic situation and decrease of unemployment. The number of newly established businesses can be a measure of optimism in the economy, of perceiving new opportunities for activity, readiness to incur investment outlays and risk.

Chart 14. The number of new entities registered in the REGON system, according to status at the end of the year

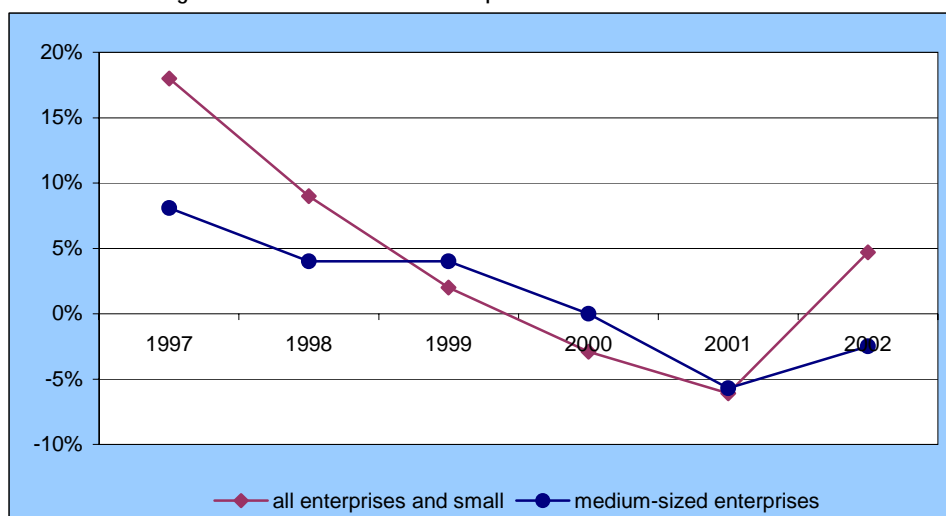


Source: Data of the Central Statistical Office, according to Polish Agency for Enterprise Development.

The number of active enterprises – those which actually function in the economy (not including firms which suspended their activity or never commenced it) – was estimated at 1,735.4 thousand at the end of 2002. Of that number, 3.6 thousand were from the public sector. In the private sector, there were 1,718.3 thousand small enterprises; 11.4 thousand medium-sized ones and 2.0 thousand large firms. Thus, only about half of registered businesses managed business activity. Compared to 2001, the number of active private enterprises rose by 78.1 thousand, or by 4.7%. Of that, the number of small enterprises rose by 78.3 thousand, while the number of medium-sized and large enterprises dropped. In the years 1996–1997, the growth in the number of active enterprises

amounted to about 18%. In 1998, the growth rate fell to 9% and in 1999 to 2%. In 2000, a decline in the number of active private enterprises was recorded, by 2.9%; and in 2001 by 6.1%. 2002 was the first year of renewed growth in the number of active enterprises.

Chart 15. Changes in the number of active enterprises



\* Small enterprises account for 99% of all enterprises – the line of their change is the same as the line of „all enterprises“  
 Source: Data of the Central Statistical Office, according to Polish Agency for Enterprise Development.

The factor, which determined an increase of the number of active enterprises in 2002, was the growth in the number of micro-enterprises – companies with up to 9 workers. The number of such enterprises rose by 5%, while in the other groups the numbers fell. The population of small enterprises was reduced by 5.8% (medium-sized by 2.5%, and large ones by 3%). Given the 2002 decline of the newly founded entities, and increase in the number of active firms, we can come to the conclusion that enterprises have learned how to deal under worse economic situation. A slight decrease in the number of medium-sized and large enterprises can prove that their situation stabilized. Meanwhile, a growth in the numbers of micro-enterprises coupled with a decrease of firms from 10 to 49 workers can mean that reduction of employment was an important element of rescue mechanisms, applied by small companies. This theory could be confirmed by the 7.5% growth of the number of persons working in

micro-enterprises, while the number of persons working in enterprises with 10 to 49 workers fell by 4.5%.

Another reason for the specific development of micro-enterprises can be the replacement of full-time employees with sole proprietor firms performing the same tasks. Such solution is favorable for the employers, due to the reduction of costs tied to social insurance contributions. In this case, the newly created companies are not a reflection of entrepreneurial spirits of the citizens. Their appearance is caused by the difficult situation in the labour market, and by the high charges tied to the social security system.

#### Financial situation of small and medium-sized enterprises

In 2002, the revenues of all active enterprises (excluding the sections of agriculture, forestry, fishery and public administration) have been estimated at PLN 1,635 billion and were 3.6% higher than a year earlier. The revenues of firms from the public sector did not change, while in the private sector they rose by 4.2%. Revenues of small enterprises rose by 3%, medium-sized by 1.6% and large enterprises by 5.4%. The increase of large companies of the private sector was very significant – it amounted to as much as 7.7%.

Of the total revenues in 2002, 63.2% were achieved by the SMEs sector: 42.8% by small enterprises, 20.4% by medium-sized ones. Despite the fact that the SMEs sector continued to develop in 2002, its significance in terms of revenues decreased. The reason for that event was a faster growth of revenues of large private enterprises.

Total revenues of enterprises owned by individuals and employing up to 9 workers fell in 2002 to about 2.5%. At the same time the number of enterprises of such type rose by 5.0%. This resulted in a decline of income per one firm, by 9.5%, to the level of PLN 25.7 thousand in 2002, compared to PLN 28.4 thousand in 2001 and PLN 26.4 thousand in 2000.

Net turnover profitability of enterprises managing full accounting and employing more than 9 workers amounted, for the whole private sector in 2002, 0.4%, as compared to 0.2% in 2001 and 0.8% in 2000. Small firms of the private sector achieved in 2002 a result of – 0.4%, compared to 0.4% in 2001 and 0.7% in 2000. The averages in the same years amounted to 0.7%, 0.7% and 1.7%, respectively. In comparison, large private enterprises achieved the ratio of gross turnover profitability of 0.5% in 2002, – 0.2% in 2001 and 0.1% in 2000.

The negative financial results had of course an influence on the investment outlays of enterprises. In 2002 the investment outlays made by private enterprises were lower by almost 25%, compared to the previous year. They fell from PLN 72.8 billion to PLN 54.8 billion. The decrease of investment outlays occurred for the first time in 2001. In 2002, investment outlays amounted to PLN 78.4 billion. They fell primarily in the small and medium-sized enterprises – by about 30%. A smaller decline of investment was registered among large enterprises. This is especially worrying, as investment outlays are usually a pretty good indicator of an enterprise's survival.

In 2002 the overall economic situation improved, turnover of the SMEs sector started growing and the number of active enterprises rose. However, the SMEs sector was not the locomotive of economic growth. Large private enterprises, often owned by foreign capital, fared better in the market. Their participation in turnover and profitability rose, and investment outlays were less limited. The growth of the SMEs sector in terms of numbers of firms is attributed to micro-sized enterprises. Their creation is often a result of difficult situation in the labour market, and by the need to escape the high contributions relating to the social security system.

#### Characteristics of micro-enterprises

The number of micro-sized enterprises, engaged in business activity in 2002, was assessed at 1,692 thousand.<sup>33</sup> (constituted 97% of all active enterprises<sup>34</sup>).

Micro-sized enterprises employ about 3.2–3.5 million persons. This means that about 20% of all employees in the national economy work in this group of companies. In 2002, employment in the sector of micro-enterprises rose again, after an earlier decline. This did not have a significant influence on the average number of employees in these entities. An average micro-sized enterprise employed about 2 persons. This confirms the belief that a majority of these firms are in fact businesses of self-employed persons, who are not employers for anybody

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<sup>33</sup> Not including agriculture, forestry and public administration.

<sup>34</sup> Entities which actually function in the economy, not including the liquidated ones and those which suspended activity or did not commence it after registration in the REGON system. The differences between the statistics of registered and active companies are due to the fact that many firms closed down in 2000 and failed to report it to the CSO; and some did not commence activity at all after registration. Many refused to file reports, and contact could not be established with some of them.

else. A significant<sup>35</sup> part of micro-sized enterprises is, in reality, just another form of hired labor. It is chosen by the employees probably to avoid the tax charges, levied on salaried work. It is worth noting that only 1/3 of the total number of employees in micro-enterprises are hired under employment contracts<sup>36</sup> – most such persons consider their work at the micro-enterprise as an additional place of work.

Table 31. Number of persons working in micro-enterprises in 1993–2002

|                    | 1993 <sup>a</sup> | 1994 <sup>a</sup> | 1995 <sup>a</sup> | 1996 <sup>a</sup> | 1997 <sup>a</sup> | 1998 <sup>a</sup> | 1999  | 2000  | 2001  | 2002  |
|--------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------|-------|-------|-------|
| Total in thousands | 2,005             | 1,827             | 1,852             | 2,139             | 2,476             | 2,660             | 3,380 | 3,432 | 3,205 | 3,404 |
| Per 1 enterprise   | 1.67              | 1.76              | 1.75              | 1.7               | 1.66              | 1.63              | 1.91  | 2.00  | 2.00  | 2.00  |

<sup>a</sup> – an enterprises with up to 5 workers

Source: CSO.

In 1993–2002, the total revenues of micro-enterprises increased, in nominal terms, almost five-fold: from PLN 88.2 to PLN 477.3 billion. It should be stressed that all this growth should be attributed to changes in methodology, introduced in 1999 (since that time, micro-enterprises are firms with up to 9 workers, while earlier this definition was applied to firms with up to 5 workers). In fact, by 1998 the revenues of micro-enterprises have exhibited a downward tendency. As the average employment in that group of enterprises fell slightly, this can suggest that self-employment is an increasingly common form among them. The most striking fact is that since 1993 until 2002, no increase in effective revenues per 1 employee was registered in the micro-enterprise sector. Thus, we could assume that labor productivity in this group of entities rose during the analyzed period only in firms with 6 to 9 employees; while the group of smaller firms experienced rather a drop in revenues per 1 employee.

Analysis of the revenues and costs of the micro-enterprises shows that they are profitable. Costs do not exceed the volume of revenues. Salaries paid to employees are a specific element of these costs, and they exhibit an upward trend.

<sup>35</sup> This is hard to calculate on the basis of aggregate data presented by the CSO, but certainly reaches several dozens percent of the total number of micro-enterprises.

<sup>36</sup> This would suggest that even as much as two-thirds of micro-enterprises could be owned by self-employed sole proprietors.

Average gross income per 1 employee has fluctuated significantly, but remained on the level of about PLN 20 to 30 thousand per year. It seems also that the larger number of firms subject to research since 1999 was the main reason for a decline in the gross profitability among micro-enterprises – although a certain decrease of profitability was observed already in 1998. This situation can be explained, in part, with the Russian crisis. As a result of collapse of Polish export to that market, it exerted a negative influence on financial results of the smallest firms.

Investment outlays in micro-enterprises are financed primarily from own resources of companies. The main reason for that situation are, probably, limitations on liquidity, which hurt small firms much stronger than large ones<sup>37</sup>. The second possible, but probably less important, reason for that situation is the rather low willingness to take risk among small businessmen. Owners of micro-enterprises first gather the necessary funds and invest when they have them, which causes the one-off expenses for investments incurred by them to be relatively small. A significant increase of their investment level could be achieved with the help of tax policy measures. Such measures could include the reduction in effective tax rates, allowing for a faster accumulation of funds needed to break the liquidity limitations, common among this group of enterprises.

### **5.3. The ownership structure and transformations of state-owned enterprises**

Privatization of the state-owned sector is one of the fundamental elements of the process of social and economic changes, which occurred in Poland after 1990.

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<sup>37</sup> This occurrence is observed in all market economies, including the highly developed economies of the USA and EU.

## Box 2. Laws regulating the privatization process in Poland

The process of privatization started in a systemic way with the adoption by the Parliament, on 13<sup>th</sup> July 1990, the law on privatization of state-owned enterprises. This law regulated, in a detailed and comprehensive manner, the procedures tied to ownership changes and privatization of state-owned business entities. After 7 years of its functioning, further privatization was conducted on the basis of the law on commercialization and privatization of state-owned enterprises. That law was adopted by the Parliament on 30<sup>th</sup> August 1996 (published in Journal of Laws no. 118/1996, item 561 with subsequent amendments). This law replaced the previous one from 13<sup>th</sup> July 1990, but retained the basic privatization paths: capital (called indirect in the law), and direct. At the same time, it defined and introduced the process of commercialization of state-owned enterprises. Currently it is the fundamental legislative act, which constitutes the basis for ownership transformations in Poland.<sup>38</sup> Aside from that law, the directions and rules for privatization are set forth in the following legislation:

- The law dated 25<sup>th</sup> September 1981, on state-owned enterprises (Journal of Laws no. 18/1991, item 80 with subsequent amendments),
- The law dated 30<sup>th</sup> April 1993 on National Investment Funds and their privatization (Journal of Laws no. 44/1993 item 202 with subsequent amendments).

On the basis of regulations contained in these laws, three fundamental procedures for dealing with state-owned enterprises are executed:

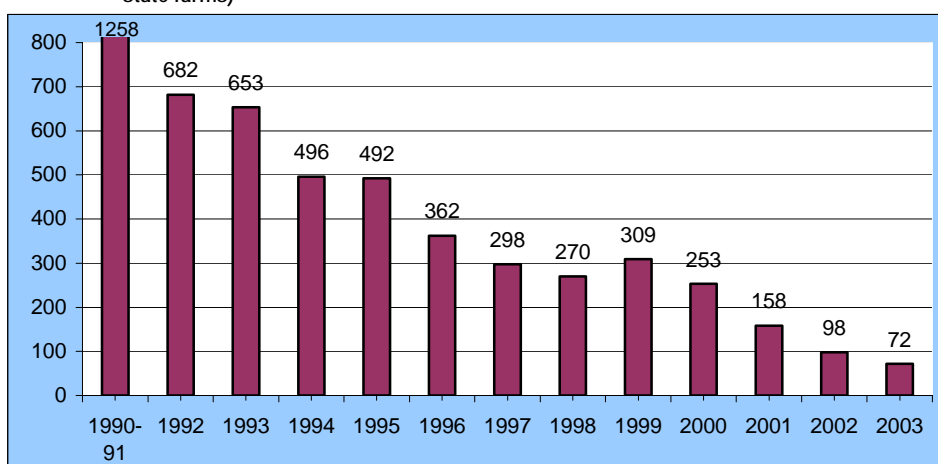
- transformation of a state-owned enterprise into a single owner company of the State Treasury (commercialization), for the purpose of further privatization or transformation of the enterprise into a company with participation of creditors, as a result of conversion of their receivables into shares,

<sup>38</sup> Since 1992, coordination process of the assets of the former state farms and the decision on their management belongs to the State Agency of Agricultural Property. Process of their liquidation had been completed in 1995. The assets of 1654 former state farms (3758.1 thousand hectares) have been included into the Stock of the State Agency of Agricultural Property, which included in their supervision also the land of the National Land Fund (608 thousand hectares).



- direct privatization through sale, contribution into company or giving the assets of privatized enterprise into paid usufruct,
- liquidation of the enterprise for economic reasons.

Chart 16. State-owned enterprises, included in the privatization process in 1990–2003 (without state farms)



Source: CSO, *Privatization of state-owned enterprises in 2003*.

The assets of former state farms are subject to a separate procedure.<sup>39</sup>

There were 6,799 state-owned enterprises (excluding state farms) on 31 December 1990 which marks the start date of the privatization process. By the end of 2003, 5,401 enterprises had been included in the process of ownership transformation. This means that 83.5% of all state-owned enterprises registered in 1990 participated, or are participating, in the privatization process.

From among that number, 28.5% were commercialised, 37.7% privatised directly and 33.8% liquidated for economic reasons.

At the end of 2002, the register of state-owned enterprises contained 1,736 entities of the state sector.

<sup>39</sup> Since 1992, coordination process of the assets of the former state farms and the decision on their management belongs to the State Agency of Agricultural Property. Process of their liquidation had been completed in 1995. The assets of 1654 former state farms (3758.1 thousand hectares) have been included into the Stock of the State Agency of Agricultural Property, which included in their supervision also the land of the National Land Fund (608 thousand hectares).

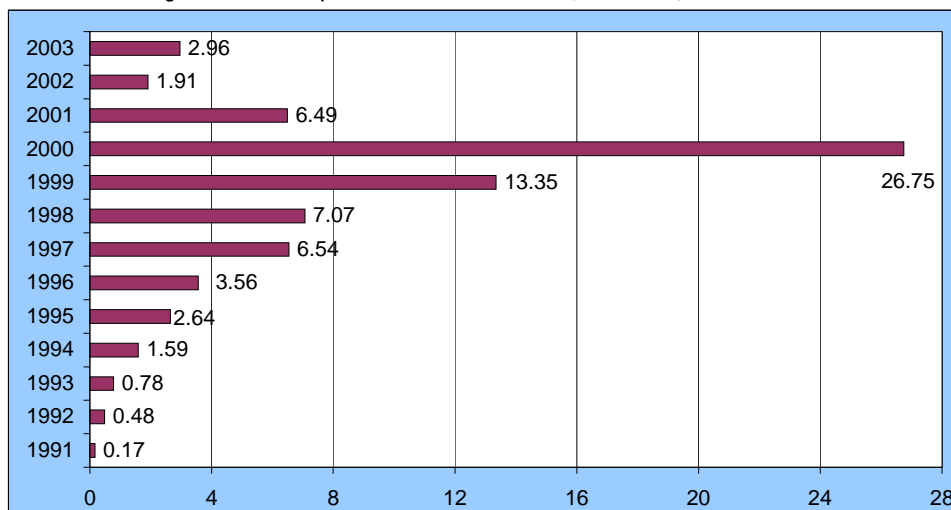
Table 32. State-owned enterprises<sup>40</sup>, included in the privatization process in 1990–2003, per sector of activity.

| Description                               | Total | Commercialised | Subjected to |                      |
|---|-------|----------------|--------------|----------------------|
|   |       |                | liquidation  | direct privatization |
| Total, of this:                           | 5,401 | 1,541          | 1,825        | 2,035                |
| Industry, of this:                        | 2,723 | 1,232          | 708          | 783                  |
| production activity                       | 2,477 | 1,049          | 678          | 750                  |
| Construction                              | 939   | 131            | 359          | 449                  |
| Commerce and repairs                      | 626   | 53             | 237          | 33                   |
| Transport, warehousing and communications | 419   | 73             | 206          | 140                  |

Source: CSO, Privatization of state-owned enterprises in 2003.

Despite the limited scope of privatization in 2003, budget revenues were higher than in 2002; and reached a level higher than those achieved during the individual years from the 1990–1995 period. At the same time, they failed to meet the level defined in the budget act.

Chart. 17. Budget revenues on privatization in 1991–2003 (PLN billion)



<sup>40</sup> Without the former state farms included in the Stock of the State Agency of Agricultural Property.

### 5.3.1. Commercialization and capital privatization

The first step to the privatization of a state-owned enterprise is its commercialization.

#### Box 3. Commercialization

Under the commercialization process, the state-owned enterprise is transformed into a sole shareholder company of the State Treasury. Next, the shares or stocks held by the State Treasury in such company are sold to investors – this is the actual privatization. Upon the approval of the Council of Ministers, commercialization can also be done for purpose other than privatization. Commercialization of state-owned enterprises is effected by the State Treasury Minister.

According to the data of the Ministry of Treasury, in 2003 the Minister of Treasury signed commercialization deeds for 14 state-owned enterprises. 12 sole shareholder companies of the State Treasury were entered into the commercial register. 7 represent the section of production activity, 2 commerce, 1 each in mining and quarrying, and the transport, storage and communication sections.

The total number of state-owned enterprises transformed into sole shareholder companies of the State Treasury reached 1,541<sup>41</sup> in 1990–2003. Another 14 were commercialized with the participation of creditors who received shares in return for their receivables. From among that group, at the end of 2003, 88.8% continued business activity, 5.2% have been taken over by other business entities, and 6% were liquidated or declared bankruptcy. Almost half (49.5%) of the sole shareholder companies of the State Treasury, created by way of commercialization, operated in the manufacturing activity sector.

The next phase of privatization is the sale of shares or stocks held by the State Treasury in the sole shareholder companies of the State Treasury (capital, or indirect, privatization).

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<sup>41</sup> Data of the Central Statistical Office.

#### Box 4. Capital privatization

Capital privatization (indirect) is done through a public offering, public tender or negotiations undertaken on the basis of a public invitation and acceptance of offer proposed by the entity publishing the invitation. The Council of Ministers publishes, in the form of a regulation, detailed manner for selling the shares or stocks, together with the conditions that should be met with respect to investment obligations, protection of natural environment, and protection of interests of employees and other persons tied to the given company. According to the provisions of the law, the shares or stocks are sold on behalf of the State Treasury by the Minister of State Treasury, or the Privatization Agency (excluding shares or stocks, which are granted to the entitled employees, farmers or fishermen).

Since the beginning of the transformation process, 335<sup>42</sup> of sole shareholder companies of the State Treasury have been privatized indirectly. Of this number, 113 companies were privatized with the participation of foreign capital. In 2003, 5 companies were privatized indirectly (2 with the participation of foreign capital). At the end of the year, business activity was managed by 298 from among the newly created private entities, of that, 97 with the participation of foreign capital. The largest number of the privatized companies operated in the production activity sector (71.1%).

#### 5.3.2. Direct privatization

Direct privatization process is applied primarily in the case of small and medium-sized state-owned enterprises.

According to the data of the Ministry of State Treasury<sup>43</sup>, by 31 December 2003 the Minister of State Treasury accepted 2,164 applications of the founding bodies of state-owned enterprises to conduct direct privatization. Of that total number, 457 applications were filed by central administration bodies. According

<sup>42</sup> CSO, Privatization of state-owned enterprises in 2003.

<sup>43</sup> Bulletin of the State Treasury Ministry, Dynamics of ownership transformation, issue no. 57, December 2003.

to the CSO, direct privatization processes included 2,035 state-owned enterprises. Privatization processes were completed in 1,959 enterprises.

#### Box 5. Direct privatization

Direct privatization is effected with the disposal of all tangible and intangible assets of a state-owned enterprise, through their sale, contribution into a company or giving them into paid usufruct.

As a result, all the tangible and intangible assets are passed over to the new owner, who becomes the legal successor of the state-owned enterprise, and assumes responsibility for the obligations and liabilities of the entity. The assets of privatized entities can be sold, contributed into a company or given into paid usufruct.

So far, the most popular form of direct privatization was the handing of assets into paid usufruct by a company established by employers (65.4% of enterprises). Sale of assets through a public tender, or negotiations on the basis of a public invitation, occurred in the case of 21.7% of enterprises. Assets of 10.1% of enterprises were contributed into newly established companies.

Table 33. Direct privatization according to the mode of disposing the assets

| Description                    | Number of state-owned enterprises according to status at 31 December of |       |       |       |
|--------------------------------|---|-------|-------|-------|
|                                | 2000  | 2001  | 2002  | 2003  |
| Direct privatization: started  | 1,850   | 1,937 | 1,998 | 2,035 |
| completed                      | 1,775   | 1,855 | 1,911 | 1,959 |
| The mode of disposal of assets |   |       |       |       |
| Sale of assets                 | 374   | 397   | 415   | 432   |
| Contribution into company      | 171   | 181   | 193   | 205   |
| Given into paid usufruct       | 1,175   | 1,223 | 1,249 | 1,268 |
| Mixed manner                   | 55  | 54    | 54    | 54    |

Source: CSO, *Privatization of state-owned enterprises*.

### 5.3.3. Liquidation for economic reasons

#### Box 6. Liquidation

Liquidation on the basis of art. 19 of the law of 25 September 1981 on state-owned enterprises is applied in case of enterprises which are in difficult economic situation and with no chance to achieve profits. Its purpose is to end the existence of the enterprise as an object – the legal person, and as an object – as the organized collection of assets, upon paying off creditors or securing their receivables. The moment of paying off creditors or securing debt marks the end of the existence of the enterprise.

Decision on liquidation is made by the founding body of its own initiative, or at the request of the employees' board of the enterprise – provided that the Minister of State Treasury does not object.

Table 34. Privatization through liquidation for economic reasons, according to the mode of disposing the assets

| Description                     |           | Status at the end of year |       |       |       |
|---------------------------------|-----------|---------------------------|-------|-------|-------|
|                                 |           | 2000                      | 2001  | 2002  | 2003  |
| Liquidation:                    | started   | 1,694                     | 1,746 | 1,795 | 1,825 |
|                                 | completed | 797                       | 820   | 852   | 904   |
| The mode of disposal of assets  |           |                           |       |       |       |
| Sale of assets                  |           | 330                       | 346   | 354   | 373   |
| Contribution into company       |           | 33                        | 33    | 34    | 34    |
| Given into paid usufruct        |           | 17                        | 17    | 19    | 19    |
| Mixed manner                    |           | 17                        | 17    | 17    | 17    |
| Other manner of assets transfer |           | 400                       | 407   | 428   | 461   |

Source: CSO, *Privatization of state-owned enterprises in 2003*.

Until the end of 2003, 1,825 state-owned enterprises have been liquidated for economic reasons. In 904 cases, this process was completed.

Liquidation of enterprise for economic reasons is usually a lengthy process, due to the difficulties with disposal of assets and paying off creditors. The materials prepared by the Treasury Ministry<sup>44</sup> show that in case of 50 enterprises, which had been liquidated in 2003, the liquidation process took 4 years on the

<sup>44</sup> As above.

average, and was very varied. In 7 cases, it took over 10 years, while in 6, less than 12 months.

#### **5.3.4. Programme of the National Investment Funds**

At the end of 2003, the State Treasury had shares in 305 companies, which participated in the NIF Program. This constituted 59.6% of the total number of 512 companies which joined the Program.

Since the start of the NIF Programme, the State Treasury sold shares or stocks in 179 companies participating in the program. It obtained revenues of about PLN 914 million. In 2003, shares of 34 companies were sold. Most of them operated in the production activity sector. The total value of sales contracts concluded for such companies amounted to almost 64 million zloty.

At the end of 2003, 18 companies with participation of the State Treasury, participating in the NIF programe, were traded publicly. 13 were listed on the Warsaw Stock Exchange and 5 on the Centralna Tabela Ofert S.A. Liquidation was conducted in 5 companies, and in 91 bankruptcy proceedings were held.





## Chapter 6

# INDUSTRY

### 6.1. Situation of industry in 2003

#### 6.1.1. Sold industrial output

After a period of economic stagnation in 2001–2002, which was characterized by a low growth of the sold industrial output amounting to 0.6% and 1.1%, respectively, in 2003 a reversal of the negative economic trends occurred.

According to data of CSO regarding the full group of economic entities, in 2003 the sold industrial output was higher by 8.4% than in the previous year. Enterprises with more than 9 employees achieved a slightly higher increase, amounting to 8.7%. A rising trend was observed in individual quarters of 2003. In Q1 2003, growth rate was comparable with the level registered in the final months of 2002 (4.4%), in the subsequent quarters growth rate was much higher and reached 12.1% in the last quarter.

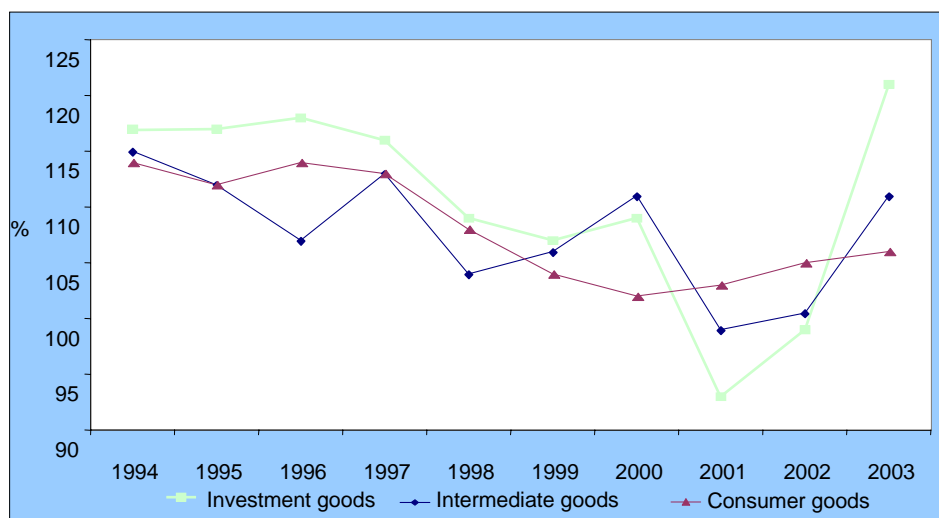
A growth in the sold industrial output in 2003 was due mainly to the higher than in 2002 level of sales in manufacturing activity. In this section, the revival of production occurred in almost all types of enterprises. This should be particularly stressed, because the last two years witnessed increases almost solely in the production of consumer goods. In 2003, manufacturers of consumer goods registered a 6% increase in their sales, while entities producing primarily investment goods increased their sales by 21%. In the area of goods for intermediate purpose, the increase amounted to 11%.

A high increase was seen in the production of those sections and groups of industry, regarded as carriers of technological progress<sup>45</sup>. Their production measured in current prices was higher by 22.5% than in 2002. This helped to increase from 12.4% to 13.7% their share in the value of output of industrial enterprises, employing more than 49 workers.

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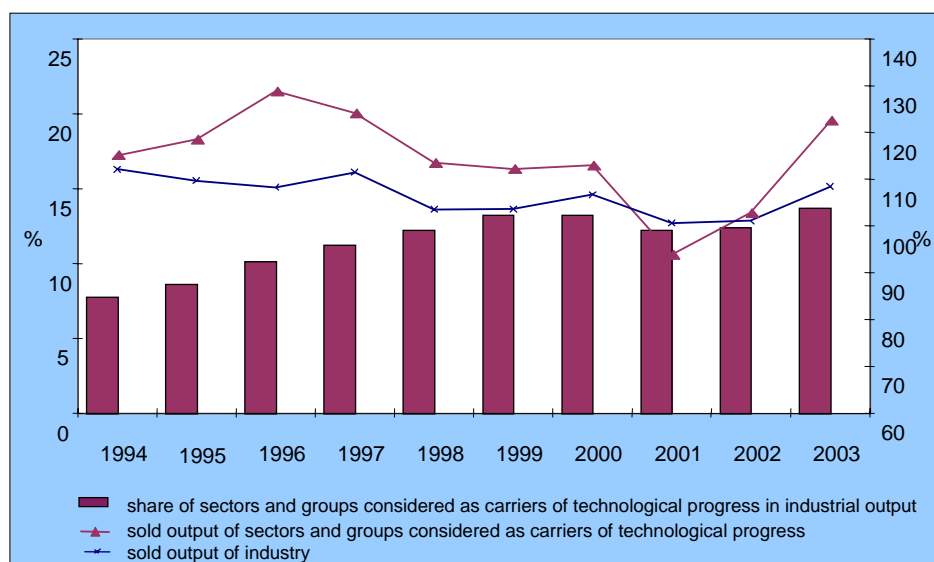
<sup>45</sup> In enterprises employing more than 49 workers.

Chart 18. Dynamics of sold industrial output per product type in 1994–2003



Source: Information on the social and economic situation of the country, CSO, years 1992–2003.

Chart 19. The share (left axis) and dynamics (right axis) of sold industrial output of these sections and groups of industry which are considered as drivers of technical progress, in 1994–2003



Source: Information on the social and economic situation of the country, CSO, years 1992–2003.

An increase in production output both in manufacturing activity and in the sections, regarded as carriers of technological progress, is due primarily to the pro-export nature of that production.

In 2003, 20 sections of industry of the total 29 achieved a higher growth of output than a year earlier. The highest increase was recorded in the production of trucks, trailers and ballast tractors (by 30.7%). Production rose significantly also in the following sections:

- production of machinery and electrical apparatuses by 22.6%
- production of furniture and other production activity by 20.4%
- production of rubber and plastic products by 20.3%
- production of machines and equipment by 16.5%
- production of metal goods by 14.3%
- production of chemical goods by 11.3%

However, many areas of industry, which are important for the economy, did not feel an improvement in their situation. In some of them similar trends have been registered in 2001–2002. This means that the poor situation in these sections is of durable nature (clothing and leather industry). A decline of production in the hard coal mining sector is the outcome of restructuring process of that section, which has been commenced a few years ago. In the shipbuilding industry, it is caused by the long production cycle.

In 2003, the largest decreases of production were found in the following sections:

- leathers and leather goods by 7.5%
- production of other transport equipment by 6.9%
- production of clothing and fur goods by 5.1%
- hard and brown coal mining, peat by 4.4%

In the first half of 2004, the volume of the sold industrial output continued to rise quickly. The main factor stimulating industrial production was high internal demand, including consumer demand, as well as external demand. As a result, from January to May production rose by 18%. The largest increases were recorded in March and April (more than 20%) which was tied to a much higher volume of orders, both from foreign contractors and Polish consumers. Poles have

expected significant price increases – especially of consumer goods – and made larger purchases. A real boom was seen in construction materials, which was tied to the expected increase of VAT rates after 1 May 2004. Quite often Polish companies in the period before accession to the EU, in an attempt to secure their external customers against delays in subsequent months, and thus to avoid losing the contractor, delivered the goods earlier. This was due to anxiety and wariness of the new, not fully known mechanisms which were introduced on 1 May; as well as to the need of meeting several criteria to be able to participate in intra-community goods exchange (such as obtaining the European tax identification number).

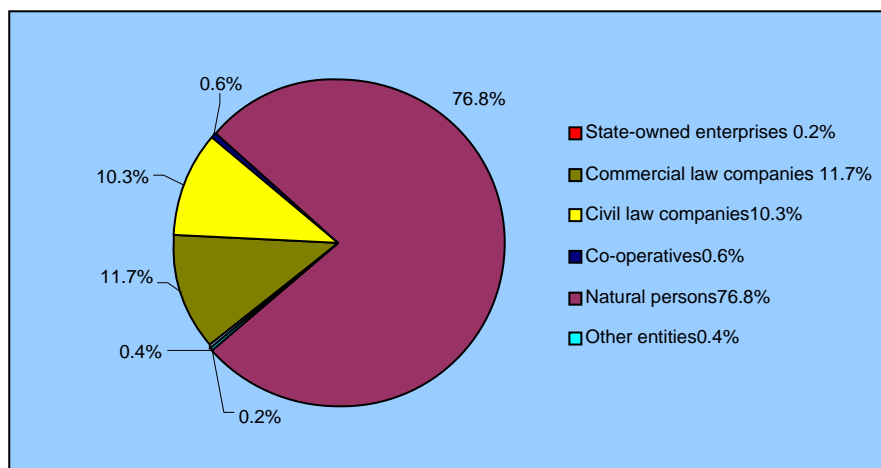
#### 6.1.2. Ownership structure of industry

The current ownership and organizational structure of the industry was formed as a result of changes which occurred in the Polish economy in the course of the transformation process, commenced after 1989. That structure is characterized by the decline in the number of entities of the public sector, and their share in the total number of entities operating in the industry sector – caused by privatization and liquidation. It is worth to stress that this share (0.9% at the end of 2003) was four times lower than in the whole economy (3.6%). Public industrial enterprises constituted in 2003 2.7% of the number of public enterprises operating in the whole economy – similarly as in the previous year. 22.3% of them belonged to the State Treasury. In the whole economy, the share of state-owned enterprises in the public sector was much smaller and amounted to 1.3%.

The higher share of state-owned enterprises in the number of all public enterprises in industry sector than in the whole economy is caused by the structure of that sector. The industry sector includes two sections of energy security: mining and quarrying, and electricity, gas and water supply. Entities from these sections are more frequently than other held by the State Treasury or local government bodies.

At the end of 2003, industrial entities constituted 10.8% of all entities operating in the national economy, while in 2002 11.0%, and in 1998 – 14%.

Chart 20. Structure of domestic industrial entities per form of ownership in 2003



Source: CSO, Structural changes in the groups of economic entities in the national economy in 2003.

Table 35. The number of enterprises of the public and private sectors, per sections in 2002–2003

| Description<br>a – 2002 r.<br>b – 2003 r.<br>c – 2002 = 100 |   | TOTAL<br>Number | Of this:           |           |                     |           |
|---|---|-----------------|--------------------|-----------|---------------------|-----------|
|   |   |                 | Public enterprises |           | Private enterprises |           |
|   |   |                 | Number             | Share (%) | Number              | Share (%) |
| Economy,<br>of this:  | a | 3,468,218       | 120,593            | 3.5       | 3,347,625           | 96.5      |
|   | b | 3,581,593       | 129,315            | 3.6       | 3,452,278           | 96.4      |
|   | c | 103.3           | 107.2              |           | 103.1               |           |
| Industry,<br>of this:                                       | a | 382,948         | 3,619              | 0.9       | 379,329             | 99.1      |
|   | b | 387,315         | 3,529              | 0.9       | 383,786             | 99.1      |
|   | c | 101.1           | 97.5               |           | 101.2               |           |
| – Mining and quarrying                                      | a | 1,971           | 105                | 5.3       | 1,866               | 94.7      |
|   | b | 2,043           | 99                 | 4.8       | 1,944               | 95.2      |
|   | c | 103.7           | 94.3               |           | 104.2               |           |
| – Manufacturing   | a | 377,667         | 2,251              | 0.6       | 375,416             | 99.4      |
|   | b | 381,823         | 2,092              | 0.5       | 379,731             | 99.5      |
|   | c | 101.1           | 92.9               |           | 101.1               |           |
| – Electricity, gas and<br>water supply                      | a | 3,310           | 1,263              | 38.2      | 2,047               | 61.8      |
|   | b | 3,449           | 1,338              | 38.8      | 2,111               | 61.2      |
|   | c | 104.2           | 105.9              |           | 103.1               |           |

Source: CSO, Structural changes in the groups of economic entities in national economy in 2003.

Table 36. Business entities in industry, per sections and main forms of ownership (status as at 31 December 2003)

| Description<br>a – 2002<br>b – 2003<br>c – 2004 = 100 |   | TOTAL     | Of this:                |      |           |      |                    |           |             |           |
|---|---|-----------|-------------------------|------|-----------|------|--------------------|-----------|-------------|-----------|
|   |   |           | State-owned enterprises |      | Companies |      |                    |           | Individuals |           |
|   |   |           |                         |      | Total     |      | Of this commercial |           | Number      | Share (%) |
|   |   |           |                         |      |           |      | Number             | Share (%) |             |           |
| Economy,<br>of this:                                  | a | 3,468,218 | 1,951                   | 0.06 | 478,972   | 13.8 | 196,681            | 5.7       | 2,714,118   | 78.3      |
|   | b | 3,581,593 | 1736                    | 0.05 | 489,738   | 13.7 | 208,753            | 5.8       | 2,795,860   | 78.1      |
|   | c | 103.3     | 89.0                    |      | 102.2     |      | 106.1              |           | 103.0       |           |
| Industry,<br>of this:                                 | a | 382,948   | 883                     | 0.23 | 83,872    | 21.9 | 43,044             | 11.2      | 295,443     | 77.2      |
|   | b | 387,315   | 787                     | 0.20 | 85,599    | 22.1 | 45,356             | 11.7      | 297,650     | 76.8      |
|   | c | 101.1     | 89.1                    |      | 102.0     |      | 105.4              |           | 100.7       |           |
| – Mining and<br>quarrying                             | a | 1,971     | 33                      | 1.67 | 1,008     | 51.1 | 701                | 35.6      | 921         | 46.7      |
|   | b | 2,043     | 29                      | 1.41 | 1,030     | 50.4 | 731                | 35.8      | 975         | 47.7      |
|   | c | 103.7     | 87.9                    |      | 102.2     |      | 104.4              |           | 105.9       |           |
| – Manufacturing                                       | a | 377,667   | 828                     | 0.22 | 81,014    | 21.5 | 40,981             | 10.9      | 293,099     | 77.6      |
|   | b | 381,823   | 738                     | 0.19 | 82,649    | 21.6 | 43,189             | 11.3      | 295,728     | 77.5      |
|   | c | 101.1     | 89.1                    |      | 102.0     |      | 105.4              |           | 100.9       |           |
| – Electricity,<br>gas and<br>water supply             | a | 3,310     | 22                      | 0.66 | 1,850     | 55.9 | 1,362              | 41.2      | 948         | 28.6      |
|   | b | 3,449     | 20                      | 0.58 | 1,920     | 55.7 | 1,436              | 41.6      | 947         | 27.5      |
|   | c | 104.2     | 90.9                    |      | 103.8     |      | 105.4              |           | 99.9        |           |

Source: CSO, *Structural changes in the groups of economic entities in national economy in 2003*.

Industry was dominated by enterprises engaged in the production activity. Among them, the largest group (13.6%) was involved in the production of metal finished products. A smaller numbers (from 11.3% to 11.5%) operated in the sections of furniture production, clothing industry and furriery, production of wood and articles of wood.

Aside from sections where there are thousands of entities, some others have several or several dozens of companies, such as: quarrying of metal ores (5), production of tobacco goods (25), mining of petroleum oil and natural gas, including service activity (57 companies).

Despite better situation in industry, in 2003 the number of firms rose by only 1.1%, as compared to 2002. The increase was almost twice smaller than in 2002. The year 2003 was also worse in terms of numbers of newly registered enterprises, and companies removed from records. In 2003, 19,759 new enterprises were registered, compared to 21,741 a year earlier; and 15,200 companies were removed from registers, compared to 14,271 in 2002. The net increase in the

number of enterprises in 2003 amounted to 4,604 firms, compared to 7,524 in the previous year. Similar tendencies, but less intense, were seen across the whole economy.

All of the growth in the number of enterprises in industry in 2003 occurred in the private sector. The number of public sector entities was reduced by 2.5%; and of that, number of state-owned enterprises went down by over 10%.

In the private sector, small businesses with up to 49 workers are particularly important. Their share in the total number of private industrial enterprises in 2003 amounted to 97.7%. Enterprises with 50 to 249 workers constituted 1.9%, those with 250-999 workers – 0.3%, and those with more than 1000 employees – 0.05%).

Table 37. Industrial enterprises per number of employees and sector of ownership in 2003

| Size of enterprise according to number of employees | Number of enterprises |                |
|---|-----------------------|----------------|
|   | Public sector         | Private sector |
| 50–249 employees                                    | 946                   | 7,234          |
| 250–999 employees                                   | 279                   | 1,333          |
| more than 1000 employees                            | 143                   | 196            |

Source: CSO, *Structural changes in the groups of economic entities in the national economy in 2003*.

Evaluating the ownership structure of industry on the basis of other economic criteria, we can also see that the private sector dominates the public one. The total average number of persons employed in industry in 2003 amounted to 2,424 thousand persons. Of that group, 75.4% worked in the private sector. In 2003, the share of the private sector in the value of the sold industrial output amounted to 77.1%, which coupled with the share in average employment suggests that labour productivity in this sector is higher.

### 6.1.3. Restructuring of industrial sectors

The late 1980's and early 1990's brought fundamental changes in all areas of life in Poland. As a result of transformation of the political system, the economic system changed radically. Competitiveness and equal rights for all business entities became the priorities. The market model required changes in the ownership structure and the new economic situation forced actions whose goal was to reform the key sectors of the Polish industry.

### Hard coal mining

The subsequent programmes for reform of hard coal mining resulted in a significant reduction of the production capacities, and a radical reduction of employment. These changes occurred with significant involvement of public funds.

Despite the progress in restructuring of the hard coal mining sector, the main problems of that sector remain unsolved: very high level of liabilities, lack of financial liquidity and excessive production potential. The importance of hard coal for Poland's energy balance requires continuation of the restructuring process. It should result in restoring mining enterprises to full economic stability and financial liquidity.

On 28 January 2003 the Council of Ministers adopted the „Programme for restructuring of the hard coal mining sector in Poland in 2003–2006, using the anti-crisis laws and initiating the process of privatization of certain mines (as amended in compliance with the provisions of an Agreement concluded with the trade unions on 11 December 2002 and including corrections required under legal status of the sector as on 10 January 2003)“.

The main tasks, defined in the Programme, included:

- introduction of structural and organizational changes,
- financial restructuring and improvement of financial liquidity;
- adapting the production capacities to the needs of the market, and adapting employment level to these capacities.

Under these tasks, the following activities regarding financial and organizational restructuring were undertaken:

- the holding company Kompania Węglowa S.A. was established on 1 February 2003, and five coal mining companies have handed their enterprises over to the Kompania
- debts of mining enterprises, amounting to PLN 18.1 billion, were cancelled on the basis of the restructuring laws. The status of the sector's liabilities was reduced from PLN 22.8 billion at the end of 2002 to PLN 8.6 billion at the end of 2003. As a result of the debt cancellation, the financial liquidity ratios also improved.



- delay, and next repayment in installments was applied to public law obligations amounting to about PLN 2.6 billion; including PLN 2.1 billion of social insurance (ZUS) contributions.

In 2003, no actions were undertaken to close down coal production in active mines. These activities were continued in mines whose liquidation commenced before 1 January 2003. Decisions were made to close down production in KWK Katowice-Kleofas and ZG Bytom II mines in 2004. Employment was reduced by a further 4.3 thousand persons. Most employees decided to retire or to change job. No new protective, activation or adaptive instruments were introduced in 2003.

The situation in the coal market is very dynamic. As the conditions change, the Ministry of Economy, Labour and Social Policy prepared information on the implementation of the „Programme for restructuring the hard coal mining sector in Poland in 2003–2006, using the anti-crisis laws and initiating the process of privatization of certain mines”. The information contained proposal for overcoming barriers found in the restructuring process. The information was approved by the Council of Ministers on 17 June 2003. Evaluation of the information made by the Council of Ministers, and the resulting decisions, were the basis to develop draft law on the restructuring of hard coal mining sector in 2003–2006. The law, which defines the necessary instruments, which allow achieving the restructuring goals, was passed by the Sejm on 28 November 2003.

In 2004 certain factors appeared which influenced the restructuring process. They included:

- rapid changes in the supply and demand in external market, strongly differing from the annual, seasonal changes of general economic situation;
- Poland's accession to the European Union and the resulting need to develop documents necessary to grant public aid to the mining sector after the 1 of May 2004, in line with the Regulation 1407/02/CE of the European Council.

The changes and market conditions, forced an update of the manner for implementing the programme of hard coal mining restructuring. This was reflected in the document adopted by the Council of Ministers on 27 April 2004, „Restruc-

turing of the hard coal mining sector during the period 2004–2006 and strategy for 2007–2010”. The document presents basic goals for restructuring of the coal mining sector in 2004–2006; and a strategy for its functioning until 2010. They are based on the diagnosis of the sector, market conditions and the introduced legislative instruments.

#### The steel and iron sector

The plans and intents regarding further restructuring of the steel and iron sector are defined in detail in the document adopted by the Council of Ministers on 10 January 2003, entitled „Restructuring of the steel and iron industry in Poland until 2006”, („the Programme”).<sup>47</sup>

The fundamental goal of the Programme is to achieve by 2006 a situation where individual entities of the sector:

- function in an effective manner under an open market conditions, without public aid,
- are characterized by productivity on the European level,
- have production capacities adapted to sales opportunities,
- are highly competitive,
- are privatized,
- comply with the European standards for environment protection.

Given the degree of advancement of restructuring processes, the financial condition and possibility for meeting the viability criteria by individual entities of the sector, and also the course of bankruptcy and liquidation processes, the adopted Programme provides for various paths of further action for the steelworks covered and not covered by restructuring, as for those which are included under bankruptcy proceedings.

According to the assumptions described in the document, public aid for restructuring that could be used to the end of 2003 was granted to seven steel

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<sup>47</sup> With reference to: the bankruptcy of the Andrzej S.A. steelworks and its removal from the list of public aid beneficiaries and amendment of the scope of production capacity reduction in the Łabędy S.A. steelworks, caused by the rejection of original proposals by the European Commission, it was necessary to introduce relevant changes into the Programme, which were accepted by the Council of Ministers on 25<sup>th</sup> March 2004.

mills: „Polskie Huty Stali” S.A. in Katowice (currently operating under the name „Ispat Polska Stal” S.A.), the Huta Bankowa Sp. z o.o. Steelworks in Dąbrowa Górnicza, „Batory” S.A. Steelworks in Chorzów, Technologie Buczek S.A. in Sosnowiec, the Lucchini Warsaw Steelworks in Warsaw, Łabędy S.A. Steelworks in Gliwice, and the Pokój Steelworks in Ruda Śląska. In 2003, in the course of implementing the government programme, the „Batory” steelworks lost the opportunity of using state aid for necessary restructuring because of its bankruptcy.

The selection of entities, which were beneficiaries of public aid, was made from the standpoint of an opportunity for implementing the restructuring goals that would guarantee that at the end of the process the enterprises achieve durable profitability and competitiveness under market economy conditions.

In line with the adopted assumptions, which were also included in Protocol 8 to the Accession Treaty, the total public aid allocated for the said beneficiaries and utilized by the end of 2003, did not exceed PLN 3.39 billion. It was designated primarily for the process of financial restructuring of these entities.

The Programme, supported with the provisions of the law dated 24 August 2001 on restructuring of the steel and iron sector (Journal of Laws No 111, item 1196) provides – in line with the global trends – a consolidation of some of the entities on the basis of their products. It recommends creating appropriate conditions primarily for consolidation of high-quality steel goods and producers of pipes. In both cases, the goal of consolidation (implemented in line with ownership strategy) is to develop mechanisms, which enable profitable operations of the enterprises’ production lines, and reorganization of the supply of the above-mentioned products.

Consolidation in a natural way establishes direct grounds, which can facilitate privatization of the sector, planned under the Programme. The primary goal of privatization policy is to prevent the so-called partial privatization, that would be contrary to the interests of the whole steel sector, as it could limit its competitiveness or market access. Therefore, the restructuring programme assumes that privatization of the Polish steel sector should be conducted with the participation of those strategic investors, who will be interested in the widest possible part of the sector – especially the integrated steelworks and steelworks which would be related to them in terms of technology.

The above concept was reflected in the founding of holding created on 6 June 2002 from four individual steelworks (Katowice S.A., the T. Sendzimira S.A. in Cracow, Florian S.A. and Cedler S.A.). On 31 December 2002, this holding was transformed into a joint stock company „Polskie Huty Stali” S.A. The establishment of PHS S.A. created the basis to commence privatization procedures of this company as a single enterprise. It had also a positive influence on the conditions for implementing the process of further consolidation of the steel sector. On 27 October 2003, the State Treasury signed a contract to sell shares of PHS S.A. to LNM Holdings N.V. On 5 March 2004, the process of privatization of Polskie Huty Stali S.A. was finalized (the company operates currently under the name Ispat Polska Stal S.A.).

The government programme and the restructuring programmes of the steelworks, assume serious reduction of operating costs, by such means as rationalization of employment. In order to obtain productivity standards similar to the ones of the European Union, the process of employment restructuring, introduced a few years ago, shall be continued but to a smaller than current extent. In 2003–2006, this will result in a reduction of employment in the steelworks covered by public aid<sup>48</sup> by about 6.9 thousand persons. Lay-offs, which require social protection mechanisms, will cover up to 3,000 persons. The process will be supported with budget funds, with the use of social protection mechanisms provided for in the law on restructuring of steel and iron sector and designated for vocational activation of steelworks employees who lose their jobs (vocational retraining, training contracts).

#### The excavation and processing of sulfur

The Polish sulfur sector since early 1990s faces problems, as mined sulfur is pushed out of the market by cheap recycled sulfur (obtained during the desulfurization process of petroleum oil and gas). This caused a fall of sulfur prices and gradual decrease of production and export.

Currently only one enterprise – KiZChS „Siarkopol” S.A. in Grzybów – excavates and processes sulfur.

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<sup>48</sup> Public aid for restructuring of entities operating in the steel and iron sector was provided until the end of 2003.

The other four enterprises – KiZPS „Siarkopol” under liquidation in Tarnobrzeg, KS „Machów” in Tarnobrzeg, KS „Grzybów” in Rzędów and PRTG „Jeziorko” in Tarnobrzeg deal exclusively with liquidation of defunct workings and the reclamation of land contaminated with sulfur, which pose serious threat to the environment. These operations are supported with resources from the National Fund for Environmental Protection and Water Management.

Gradual liquidation of the sulfur industry is tied to significant reduction of employment, which causes an increase of unemployment in the Tarnobrzeg region.

The „Programme for restructuring sulfur mining and processing in Poland”, adopted by the Council of Ministers on 13 February 2001, is an attempt to solve the problems of the sulfur industry. The programme formulated the following goals:

- to bring back to economic effectiveness the widest possible part of the sulfur mining and processing sector, and to liquidate the permanently unproductive areas of activity;
- to maximally alleviate (for the employees of the sulfur sector and the local job markets) the results of rapidly decreasing number of jobs in the sulfur industry, in the case when the production programme of these enterprises is seriously reduced;
- to remove environmental threats, which arose as a result of excavation of sulfur in strip mines and open pits and to guarantee reclamation of degraded land.

Under the Programme enterprises of the sulfur sector would be consolidated in order to improve their financial situation and to accelerate liquidation processes.

In August 2003, a law was adopted on amending the law of 14 July 2001 on financial restructuring of the sulfur excavation sector.

#### **The zinc and lead ores mining**

As the deposits of the zinc and lead ores in ZGH „Bolesław” S.A. in Olkusz and ZG Trzebionka S.A. in Trzebinia are gradually becoming exhausted, these mining enterprises will have to be liquidated. Metallurgy works – ZGH „Bolesław” S.A. and HC „Miasteczko Śląskie” S.A. would have to switch their production to imported concentrates of zinc and lead.

As these enterprises do not have sufficient own funds, liquidation of mining enterprises (including the reclamation of land) is financed with state budget funds.

In 2004, the state-owned enterprise ZGH „Bolesław” was commercialized (on the basis of the law on commercialization and privatization of state-owned enterprises, of 30 August 1996 – Journal of Laws of 1996, No 118, item 561) and transformed into a sole proprietor company of the State Treasury: ZGH „Bolesław S.A.

At the initiative of social partners, a Permanent Consultation Mechanism was developed. Its purpose is to monitor the situation in the zinc and lead sector, and to solve the problems on an ongoing basis. This body includes representatives of the Ministry of State Treasury, which performs the owner's supervision functions, Ministry of Economy and Labour, representatives of employers, and of social partners. The meetings of the Permanent Consultation Mechanism are attended by representatives of the Ministry of Finance, National Fund for Environmental Protection and Water Management and local authorities.

In view of the planned liquidation of the ZGH „Bolesław” S.A., a special Coordination Team was appointed. Its task is to choose the most favorable solution for the problem regarding future supply of potable water to residents of the Olkusz region.

#### **Industrial defence potential (IDP)**

In May 2002, the Council of Ministers adopted a document „*Strategy of structural transformations of the industrial defence potential in 2002–2005*”. The concept for structural reconstruction of the IDP, presented in that document, takes into account the restructuring activities conducted so far in that sector. At the same time, the Strategy follows the tendencies to concentrate capital and production structure, which is characteristic for the European and American defense industry.

Implementation of the economic and legal mechanisms, and the legal solutions proposed under the Strategy, should enable the transformation of the IDP into a consolidated and flexible sector of production, based on sound economic and financial grounds. The basic problem of the sector is that resources of production factors are used to a relatively small extent. Coupled with the high costs

of their maintenance, this does not guarantee sufficient profitability of the production of armament and military equipment, and reflects negatively on the economic and financial condition of enterprises of that sector.

The Council of Ministers designated two basic directions of transformation of the IDP in the Strategy. They include:

- capital consolidation of entities of the IDP, by creating two capital groups (the ammunition, missile, artillery and armoured forces group, in which the Foreign Trade Enterprise BUMAR Sp. z o.o. plays a dominant role; and the aviation, radio and electronics consortium, centered around the Industrial Development Agency – ARP S.A.);
- privatization of companies which remain outside the capital groups. In case of some entities, it should be preceded by restructuring process.

In 2003, the first phase of building capital groups was completed. The ammunition, missile, artillery and armoured forces group (BUMAR) includes 11 entities of the sector, and the aviation, radio and electronics consortium (ARP) – 5 production companies and 1 commercial firm. Shares in five other companies from the IDP sector, which are currently being restructured, shall be contributed into the increased capital of Foreign Trade Enterprise Bumar Sp. z o.o. in 2004.

Part of the IDP companies, which remain outside the capital groups, would undergo privatization, in some cases linked to restructuring activities. All activities undertaken in this area will, primarily, attempt to secure the mobilization needs of the economy; and secondly, to increase the attractiveness of the companies' assets. This should facilitate the search for investors ready to engage serious capital resources. This is very important, as the defense sector did not, so far, enjoy high interest among investors – including foreign ones. As a result, only three companies of the sector were privatized so far. Most of the financial resources obtained during privatization process should be – according to the current law – used to support the restructuring processes of the defense sector, and the technical modernization of the Polish Armed Forces.

Consolidation of the IDP, proposed under the Strategy, is already showing the first positive results. The market position of these companies and their export capacities were strengthened. Further effects of consolidation – such as rationalization of production capacities and production costs, modernization of market offering, increase of export capacities – are expected in the coming years.

The process of privatization of the IDP is going slower than assumed under the Strategy. This is caused primarily by poor interest among the domestic and foreign investors, and also by the fact that the companies are not fully prepared for privatization.



## Chapter 7

# CONSTRUCTION

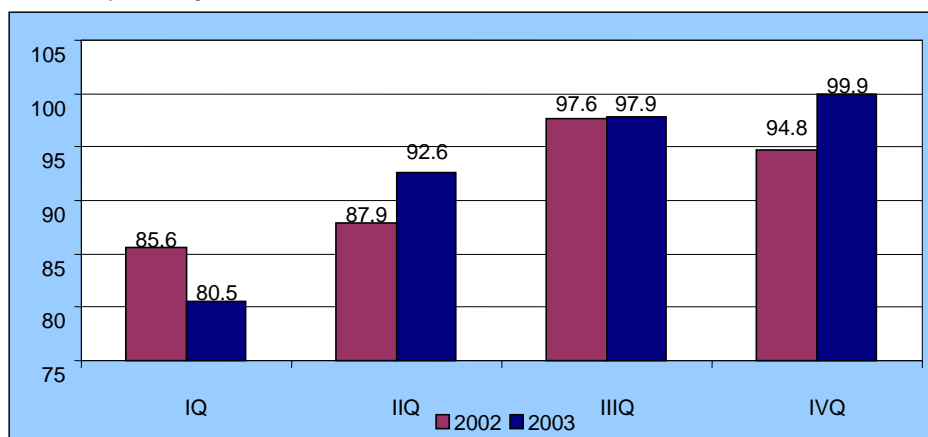
### 7.1. Dynamics and structure of the construction and assembly production

In 2003, the economy saw a significant improvement of its overall condition. This was not accompanied by a significant improvement of the situation in construction sector.

Gross value added generated by this sector amounted to PLN 41,552 million in 2003 and the sales of construction and assembly production of entities with more than 9 workers reached PLN 37,403 million.

Gross value added dropped by 5.1% (by 6.5% in 2002). However, it should be noted that dynamics picked up gradually in the subsequent quarters (from 80.5% to 99.9%). This proves that the negative trends registered in the construction sector in the last years have been stopped.

Chart 21. Dynamics of gross value added in 2002 i 2003 (%) (fixed prices, corresponding quarter of previous year = 100)



Source: Statistical Bulletin No 4/2004, CSO, p.36.

Construction and assembly production reduced its volume, similarly as during the last two years. According to data of the CSO, a decline in production (of all the registered entities) reached 3.4% and varied significantly across the ownership sectors: in the private sector 2.9%, and in the public sector 22.0%.

The decline in production was caused primarily by smaller volume of new project works – reduction by 4.4% (compared to 12.1% in 2002). Despite that reduction, the share of new project works in the construction and assembly production rose from 72.4% to 73.6%.

Dynamics of production was very varied among the groups of enterprises, broken down per profile of their operations, and ranged from 86.0% to 156.4%.

Table 38. The dynamics of construction and assembly production (in fixed prices) in enterprises with more than 9 workers, in 2002–2003

| Description   | Construction and assembly production |       |
|---|--------------------------------------|-------|
|   | 2002                                 | 2003  |
|   | previous year = 100                  |       |
| TOTAL   | 89.5                                 | 94.1  |
| of that groups of enterprises, whose basic type of activity is: |                                      |       |
| – Land preparation  | 92.8                                 | 156.4 |
| – Erecting of buildings, land and water engineering             | 90.4                                 | 94.6  |
| – Construction installations                                    | 83.3                                 | 86.0  |
| – Finishing works   | 108.4                                | 136.5 |

Source: Information on the social and economic situation of the country, 2003, CSO, p. 75.

Further improvement of the economic situation during the first months of 2004 influenced the growth of construction and assembly production, which in April 2004 was 25% higher than a year earlier. However, the main factor accounting for such a large growth was the short-term increased demand for construction production. This demand was of a pre-emptive nature – it was caused by expectations regarding increases in the costs of production, prices and construction services, as well as higher VAT rate on construction materials after Poland's accession to the European Union.

In May 2004, the construction and assembly production, realized by enterprises with more than 9 employees, was lower by 13.4% than a year ago. During the five months of 2004, the growth reached barely 0.5%, compared to the same period of the previous year.

## 7.2. Ownership structure

Construction and commerce are the most privatized sections of the economy. Starting from 1995, the share of the private sector in the total value of production and employment of the construction and assembly sector has been rising. The private sector dominates in construction and determines its results.

Table 39. The structure of construction and assembly production and average employment volume in the construction sector, per ownership sectors, in 1995–2003

| Ownership sectors | Construction and assembly production <sup>a)</sup> |       |       | Average employment <sup>b)</sup> |       |       |
|-------------------|--|-------|-------|----------------------------------|-------|-------|
|                   | 1995   | 2002  | 2003  | 1995                             | 2002  | 2003  |
|                   | in %   |       |       |                                  |       |       |
| TOTAL             | 100.0  | 100.0 | 100.0 | 100.0                            | 100.0 | 100.0 |
| Public sector     | 12.1   | 2.4   | 2.0   | 25.1                             | 9.2   | 9.0   |
| Private sector    | 87.9   | 97.6  | 98.0  | 74.9                             | 90.8  | 91.0  |

a) the data applies to the full group of entities

b) entities employing more than 9 workers

Source: Statistical Bulletin of the Central Statistical Office, No 4/2004, p. 37–38.

The Polish construction market has about 176 thousands of operating enterprises. Of that, 97% constitute firms with up to 20 workers. These companies play an important role, especially in local markets.

## 7.3. Housing construction

In 2003, the situation in the housing market picked up significantly. Almost 163 thousands housing units were completed, which was 65 thousand more than in 2002. An increase was recorded in all forms of housing construction, with the exception of cooperative and municipal. The highest increase was achieved in individual housing and in housing for sale or rental.

A significant growth in the number of housing units completed in 2003 was tied to the completion of legal requirements tied to completion of works by investors, especially private ones, before the effective date of amendments to the Construction Law. According to these amendments, the date for completing

a building (residential unit) is the date of obtaining residency permit, or date of reporting completion of works.

Table 40. Number of completed housing units, per forms of construction in 2002–2003

| Forms of residential construction | 2002            |            | 2003            |            |
|-----------------------------------|-----------------|------------|-----------------|------------|
|                                   | Number of units | 2001 = 100 | Number of units | 2002 = 100 |
| TOTAL                             | 97,595          | 92.1       | 162,635         | 166.6      |
| Individual                        | 52,433          | 129.0      | 117,891         | 224.8      |
| Designated for sale or rental     | 21,970          | 74.7       | 23,917          | 108.9      |
| Cooperative                       | 15,406          | 59.6       | 12,069          | 78.3       |
| Social rental                     | 4,653           | 68.8       | 5,808           | 124.8      |
| Municipal                         | 2,525           | 108.9      | 2,020           | 80.0       |
| Owned by enterprises              | 608             | 60.6       | 930             | 153.0      |

Source: *Housing construction 1st – 4th quarter 2003*, CSO 2004, p. 5.

## 7.4. General issues of the construction sector

The construction sector offers services for investment activities. The volume and direction of changes in the production and assembly construction is closely tied to the investment processes, occurring in the economy. In the recent years, investments were reduced, which led to a decline in the construction and assembly production.

The main problems appearing in the activity of construction and assembly enterprises, which influenced the results achieved by that sector in 2003, included:

- long-term and very deep decline in investment outlays. It led to a decline of the demand for construction services, reduction of construction and assembly production, and a significant worsening of the economic situation of enterprises. In 2003, the construction sector utilized barely 44% of its existing production capacity. Full utilization of production capacity would allow to increase production by 42%;
- large difference between the potential and the effective demand for various forms of housing construction (primarily individual), resulting from high unemployment (over 3 million persons) which limits the effective demand, low effective demand hinders development of construction;

- relatively high interest rates on credits (despite decreases of these rates), and a difficult access to credits, caused by lack of creditworthiness; these circumstances significantly reduce a supply of the construction sector with external financial resources;
- high employment costs, which slow down the process of hiring new workers. It also seems necessary to reduce the barriers, which are encountered in the course of an investment process. In the opinion of investors the major barriers and limitations encountered at individual stages of investment projects include:
  - lack of a systemic approach to land development and zoning,
  - lack of definition of line infrastructure projects, and lack of matching regulations to the needs of such investments,
  - the need to prepare a report on environmental impact of a project before obtaining land development conditions decision,
  - problems with changing the status of land from agricultural to construction,
  - unclear rules for the management of greenery located at the construction lot, the abuse of monopolistic position of municipal service enterprises, and the fact that municipalities and municipal enterprises avoid the obligation to build roads and major infrastructure.<sup>49</sup>

Improved competitiveness of Polish construction enterprises will be possible only under conditions of high and stable (lasting for several years) growth of the whole economy.

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<sup>49</sup> Report „Investment construction process” – investment barriers and proposals for improvement actions – document adopted by the Council of Ministers on 9 March 2004.

## Chapter 8

# INTERNAL TRADE

## 8.1. Commodities turnover

In 2003, the total value of commodities sold in the trade sector reached PLN 870.4 billion. Increase of sales reached 1.3%, compared to 2002. This means that the growth rate was slower than in the previous years.

Table 41. Dynamics of commodities sale in trade in 2000–2003 (%)

| Description     | 2001/2000 | 2002/2001 | 2003/2002 |
|-----------------|-----------|-----------|-----------|
| Total sales     | 103.2     | 103.9     | 101.3     |
| Wholesale sales | 102.4     | 105.0     | 99.1      |
| Retail sales    | 104.2     | 102.6     | 104.0     |

*Source: Calculations by the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data from the Central Statistical Office.*

The lower overall dynamics of sales was caused by the decline in wholesale trade (from PLN 473.7 billion in 2002 to PLN 469.6 billion in 2003). This should be seen as a natural outcome of development processes occurring in commerce; and as a reflection of actions which shorten distribution channels, undertaken by enterprises in order to reduce costs of turnover and improve competitiveness. An analysis of the sector and type based structure of wholesale sales leads to the conclusion that a decline in the sales value is seen in the group of food articles, which constitute the primary commodity of large retail networks. These networks get their supplies mostly directly from the producer.

An increase in the value of retail sales (from PLN 385.3 billion in 2002 to PLN 400.7 billion in 2003) was caused more by higher domestic demand than growth of prices. In 2003, the Consumer Price Index rose by 0.8% 2002 (1.9% in 2002), while private consumption of households rose by 3.3% (2.1% in 2002).

## **8.2. Retail commerce**

In 2003, there had been 447.9 thousand shops, of which 99.7% belonged to the private sector<sup>50</sup>. Compared to 2002, the number of shops was reduced slightly (by 0.6%). This means that over the last five years the number of shops stabilized, but individual years witnessed some increases and declines.

The retail network is undergoing more and more quality changes, which is proven by the growth of:

- the urban ratio (sales area per 1,000 residents) – from 640.0 m<sup>2</sup> in 1999 to 887.7 m<sup>2</sup> in 2003;
- average sales area of the shops – from 54.9 m<sup>2</sup> in 1999 to 75.5 m<sup>2</sup> in 2003;
- the share of large sales centers (such as supermarkets, hypermarkets, department stores, malls) in the total sales area of shops (19.2% in 2003, compared to 14.3% in 1999).

The sector-based structure of shops has undergone only slight changes in the last five years. Specialized stores still have relatively small importance, despite the fact that their share in the structure of sales outlets in Poland rose to 3.3%, as compared to 2.3% in 1999.

## **8.3. Wholesale trade**

Current changes in the wholesale trade in consumer goods in Poland – despite foreign models – take a different course than the one in developed market economies. The reasons for this situation are tied to the following conditions:

- change of relation between the producers and commercial intermediaries (the market power shifted from the production area towards trade);
- the ease of commencing business activity and market entry by new entities, which caused a scattering of the retail and wholesale trade structure. The same applies to production;

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<sup>50</sup> The CSO includes also cooperatives in the private sector. Cooperatives are systematically losing their share in the network of shops all over the country (3.6% as compared to 4.4% in 1999).

- the still present scattering of producers (as a result, most domestic production enterprises do not see economic justification for building their own distribution channels);
- the still present scattering of retail traders (as a result, most small, independent retail salesmen have no chance to establish direct contacts with producers or importers, and are in fact forced to use the services of traditional wholesale intermediaries);
- expansion of foreign distributors, which forced domestic wholesale traders, despite their economic and market weakness and the disintegration of their large part, to engage in combat with strong competitors, who have also proven know-how and skills;
- lack of strong pressure from producers and retailers on the wholesale intermediaries, to increase the level of their functions.

As a result, a variety of traditional forms of institutional wholesale sales developed. Most of them offers the simplest transaction and communication services. On the other hand, the rate of concentration and integration processes is slow (such as the establishment of distribution centres, logistics centers, warehouse centres). These processes are inspired and carried out almost solely by foreign capital. As a result, Poland still has – contrary to the situation in countries with a developed market economy – a multi-channel system for distribution of consumer goods, in which an important role is and still will be played by traditional wholesale intermediaries.

## **8.4. The size and ownership structure of internal trade**

In 2003, the CSO recorded 1,199.7 thousand trading companies operating in the market. Of this total number: 269.4 thousand of wholesale and commission sales entities, 799.5 thousand retail firms and 124.5 thousand firms which sell and repair vehicles, and sell fuels.

A large share of micro-enterprises (97.4% of all trade firms) determines the mechanisms of functioning, directions for development, results of activity and customers' satisfaction with the functioning of that area of economy.



The ownership structure of trade enterprises is dominated by individuals in terms of numbers (963.7 thousand entities), but in terms of development rate, commercial companies take the lead (76.6 thousand entities). 26.6% are companies with foreign capital. In recent years, the dynamics of their number weakened significantly, in comparison to the dynamics of domestic firms. In 2003/2002, the dynamics reached 103.8% for companies with foreign capital, and 106.9% for domestic companies.

Foreign enterprises contribute to quality changes in Polish retail trade. The two years (2001–2002) of high level of foreign investment in the trade sector (USD 3.1 billion, or 40% of all outlays made by foreign investors in the trade sector since the early 1990's) brought about delayed effects in 2003. Investments were reflected in faster development of large-area trade premises (retail and wholesale), trade centres and malls, and in the increased number of retail networks. This increased the processes of capital, function and spatial concentration of trade. Concentration of resources of large retail networks is accompanied with consolidation processes occurring as a result of takeovers of part of the assets. For example, part of the Jumbo supermarkets were taken over by the Dutch Ahold company, some of the stores from the Rema 1000 network were acquired by the operator of the largest Polish discount stores network – Biedronka, owned by Jeronimo Martins Dystrybucja, and the discount Edeka stores were bought by the Polish company called Rojal Market. It is worth reminding that in 2003 foreign investment slowed down, to the level of USD 541.1 million, which constitutes 35% of their value of 2002, in line with the general trend for a decline of investment outlays in trade. However, increased investment incentive that has been observed since mid-2003, especially among large and medium-sized enterprises, announces a reversal of the downward tendency.

The year 2003 brought positive changes in the gross and net turnover profitability ratios in trading enterprises. They offer hope for increased accumulation and investment capacities of enterprises, including domestic ones.

## **8.5. General issues of internal trade**

The year 2003 witnessed an increase in integration attempts, which resulted mainly in establishment of association of retail traders and purchasing groups operating on local and regional levels. Consolidation processes deepened among large, integrated trade networks of national and regional reach, such as: PSH Lewiatan '94 Holding, Lewiatan Detal Holding, ABC-Eurocash, and the network of 305 Cooperatives „Społem”. The deepening integration processes include not only the market of food articles (where they dominated so far), but also non-food articles. The most notable examples include the franchise discount clothing stores – SNC and Cenowa Bomba, or shoe stores – Ambra, CCC.

In 2003, the number of franchising networks grew rapidly – 40 new ones were established. The networks were integrated by organization, or by capital. There are 88 systems operating in the Polish market, with a total of 7,805 franchisees.

The important issues of internal trade include the development of cooperation among the elements of distribution channels of consumer goods. The research of the Institute of Home Market and Consumption suggests that:

- the conditions for cooperation of producers between the integrated domestic networks and foreign trade networks are becoming gradually equalized, both groups of trading companies, trying to rationalize the costs of goods deliveries, attempt to transfer their largest possible portion to the suppliers, who are the weaker party during negotiations;
- official regulations for payment deadlines in business turnover have been introduced, and served to reduce the scope of payment delays in distribution channels;
- an amendment to the law on combating dishonest competition reduced slightly the scope of problems tied to the growing costs of producers' cooperation with retail networks (constant promotions, special fees);
- the dynamically developing trade brands are a controversial occurrence. (they constitute 15–17% of the value of sales of every day goods – FMCG) and are seen as an opportunity for small producers to enter foreign markets and achieve economies of scale. Sometimes they are seen also as a threat for producers' brands, especially local ones, and for small shops which cannot

cope with price competition, resulting from the dynamic development of trade brands, characterized by low prices.

The year 2003 again witnessed an aggravation of issues tied to location of large-area retail premises and their opening hours. This led to proposals for their statutory regulation.

## Chapter 9

# FOREIGN TRADE

The scope, dynamics, structure and balance of commercial exchange in 2003 was largely determined by the dynamic increase of export. It was a very important – perhaps even the fundamental – factor which fuelled the growth of production. Given the strong import dependence of the Polish economy, it translated into significant revival of import, especially intermediate one. Thus, the export-related factors occupied a major position among the factors, which determined Polish trade exchange. They included in particular:

- a clear and durable appreciation trend of the common European currency towards the US dollar and PLN,
- low inflation,
- reduction of the effective unit labour costs in industry,
- export effects of the foreign direct investment (FDI),
- limited internal demand,
- lack of economic revival in the main European markets.

Among the main conditions determining the dynamics and scope of import in 2003, the following should be mentioned:

- exchange rate shock, especially in import from the EU – caused by the significant depreciation of PLN to EUR,
- increases of the prices of goods, especially raw materials, in the global market,
- relatively high import flexibility of the development of Polish economy.

## 9.1. Dynamics of overall export and import, and in the individual geographic regions

### 9.1.1. Foreign trade turnover in payment terms (according to NBP data)

After a period of slower growth, and even a decline (in Q4 of 2001 and Q1 of 2002) of commodities exchange measured in payment terms, a clear growth tendency has been observed since mid-2002. This tendency became more permanent in 2003. This is illustrated in the table below:

Table 42. Foreign trade turnover in payment terms in 2003

| Quarters | Exports     | Imports | Balance | Dynamics (%)                   |        | Exports | Imports | Balance | Dynamics (%) |       |  |                                |         |
|----------|-------------|---------|---------|--------------------------------|--------|---------|---------|---------|--------------|-------|--|--------------------------------|---------|
|          |             |         |         | Export                         | Import |         |         |         |              |       |  | Exports                        | Imports |
|          | USD million |         |         | same period of past year = 100 |        |         |         |         | EUR million  |       |  | same period of past year = 100 |         |
| 1/2002   | 6,884       | 9,512   | -2,628  | 92.6                           | 89.9   | 7,853   | 10,847  | -2,994  | 97.4         | 94.7  |  |                                |         |
| 2        | 7,970       | 10,206  | -2,236  | 106.2                          | 99.2   | 8,668   | 11,109  | -2,441  | 100.9        | 94.3  |  |                                |         |
| 3        | 8,675       | 11,073  | -2,398  | 116.3                          | 108.6  | 8,816   | 11,259  | -2,443  | 105.2        | 98.3  |  |                                |         |
| 4        | 9,416       | 12,506  | -3,090  | 119.6                          | 114.8  | 9,409   | 12,497  | -3,088  | 107.1        | 102.8 |  |                                |         |
| 2002     | 32,945      | 43,297  | -10,352 | 108.8                          | 103.2  | 34,746  | 45,712  | -10,966 | 102.7        | 97.6  |  |                                |         |
| 1/2003   | 8,970       | 11,343  | -2,373  | 130.3                          | 119.2  | 8,352   | 10,577  | -2,225  | 106.4        | 97.5  |  |                                |         |
| 2        | 10,162      | 12,456  | -2,294  | 127.5                          | 122.0  | 8,937   | 10,968  | -2,031  | 103.1        | 98.7  |  |                                |         |
| 3        | 10,617      | 12,962  | -3,016  | 122.4                          | 117.1  | 9,432   | 11,516  | -2,084  | 107.         | 102.3 |  |                                |         |
| 4        | 13,060      | 15,717  | -2,657  | 138.7                          | 125.7  | 10,949  | 13,170  | -2,221  | 116.4        | 105.4 |  |                                |         |
| 2003     | 42,809      | 52,478  | -9,669  | 129.9                          | 121.2  | 37,670  | 46,231  | -8,561  | 108.4        | 101.1 |  |                                |         |

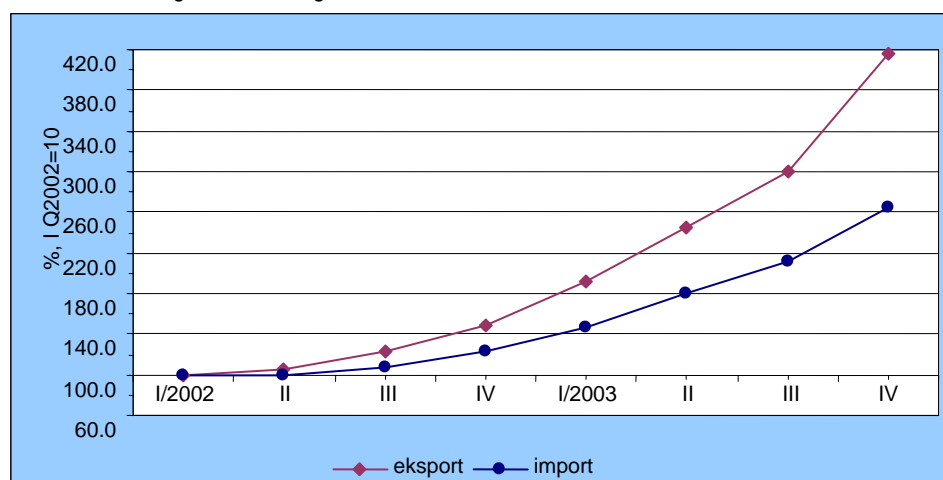
Source: Data of the National Bank of Poland.

A revival of turnover was accompanied by further reduction in the deficit of commodities exchange, especially expressed in EUR (reduction by EUR 2.4 million, compared to the previous year). The year 2003 was the fourth subsequent year of the reduction of deficit in commodities exchange and improvement of the balance of payments turnover, measured as relation of the balance to export revenues (from the level of -31.4% in 2002 to -22.6% in 2003).

Such high growth of turnover expressed in USD has not been seen since 1995, especially on the export side (30%). It remained in place from the beginning to the end of 2003, despite the fact that the reference level from Q4 of 2002 was already relatively high (USD 3 billion per month). Under such circumstances, the average ratio of increase of export revenues in Q4 of 2003 on the level close

to 40%, and their level of more than USD 4.3 billion for the least three months, are proofs of unprecedented acceleration of export<sup>51</sup>. A similar growth of turnover has been recorded on the export side in terms of absolute scale, but slightly lower in terms of speed.

Chart 22. Changes in the foreign trade turnover in 2002–2003



Source: Calculations of the Economic Analyses and Forecasting Department the Ministry of Economy and Labour, on the basis of data from the NBP.

The dynamics of turnover growth, calculated in EUR, was much smaller than measured in USD. This results, on one hand, from the relatively high increase of turnover expressed in that currency in the base year – 2002, when the exchange rate of the EUR was lower than of the dollar; and on the other hand, from the very significant (by about 20%) appreciation of the European currency in 2003.

An analysis of the geographical structure of commodities exchange, measured in USD, shows a significant share of countries of the European Union (especially Germany) in payments tied to foreign trade (almost 70%, both in terms of export revenues and import costs). Turnover with other countries, especially with the USA, also occupies a significant position.

<sup>51</sup> The average level of export revenues in the 3 last months of 2003 amounted to USD 4,353 million and was by almost USD 790 million higher than the average monthly value for the whole year. Similarly in the case of costs of import – their average monthly level in Q4 of 2003 (USD 5,239 million) was higher by USD 810 million from the average value for the whole year.

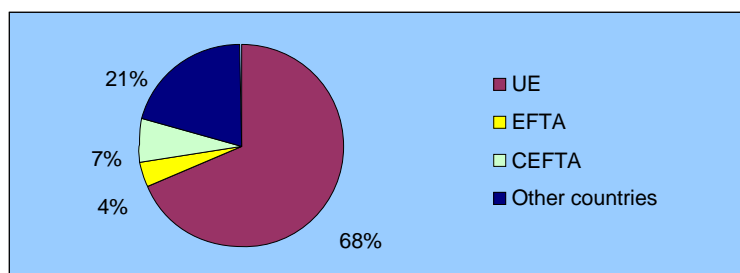
Table 43. Foreign trade turnover in 2003

| Groups of countries | Export revenues | Import expenditures | Balance | Dynamics 2002 = 100 |         | Structure in % |         |
|---------------------|-----------------|---------------------|---------|---------------------|---------|----------------|---------|
|                     | USD million     |                     |         | Exports             | Imports | Exports        | Imports |
| POLAND              | 42,809          | 52,478              | -9,669  | 129.9               | 121.2   | 100.0          | 100.0   |
| of this:            |                 |                     |         |                     |         |                |         |
| European Union      | 29,300          | 36,307              | -7,007  | 129.2               | 120.8   | 68.3           | 69.1    |
| EFTA                | 1,811           | 4,157               | -2,346  | 167.7               | 135.8   | 4.2            | 7.9     |
| CEFTA               | 2,864           | 2,858               | 6       | 153.5               | 144.0   | 6.7            | 5.4     |
| Other countries     | 8,941           | 9,256               | -315    | 121.3               | 112.9   | 20.8           | 17.6    |

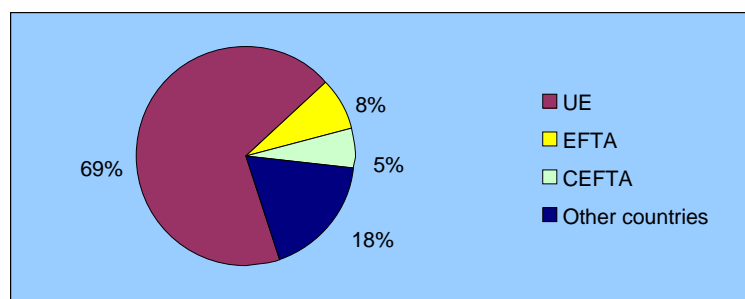
Source: Data of the National Bank of Poland.

Chart 23. Geographical structure of the foreign trade turnover in 2003

a) export revenues



b) import expenditures



Source: Data of the National Bank of Poland.

The streams of payment turnover tied to commercial transactions, flowing between the Polish banking system and foreign banks operating in the individual geographical areas, differ strongly from the streams of physical flow of goods between Poland and other groups of markets. The disproportion between the scope of commodities and payments turnovers is particularly high in case of trade with Russia and the United States. A significant portion of payments for export to

Russia and for import from that market flows via American banks. As a result, commodities turnover with Russia significantly exceeds payments turnover with that country, while a reverse situation is found in trade with the USA.

#### 9.1.2. Commodities turnover (CSO data)

In 2003, the value of exported commodities reached USD 53.6 billion, and was higher by USD 12.6 billion – or by 30.6% – higher than during the previous year. The growth rate of imports during that period (from USD 55.1 billion in 2002 to USD 68 billion in 2003) was lower by 7 percentage points; but its growth in absolute terms was higher by over USD 0.3 billion. This caused an increase in turnover deficit, from USD 14.1 billion to USD 14.4 billion.

The dynamics of turnover growth, measured in EUR, was definitely lower during the analysed period than its value in USD.

The difference in the growth rates of turnover, both in exports and in imports, is explained primarily by the significant appreciation of EUR in relation to the USD that occurred since 2002. Aside from depreciation of PLN, two other factors influenced the smaller growth of turnover measured in EUR:

- higher reference level of turnover calculated in EUR, compared to the USD value in 2002 which is used as the base year,
- change of the currency structure of foreign trade settlements in 2003, compared to the previous year (bigger share of EUR and PLN at the cost of USD on the export side; and a slight decrease of the share of EUR and USD for PLN on the import side).

Aside from a significant growth in the volume of turnover, 2003 brought also further improvement of quality of Polish exports. This was expressed in a more modern offer of goods and its increased competitiveness. These positive tendencies reflect the progress in the restructuring of the economy, achieved under the conditions of significant involvement of foreign capital.

Modernization and increased competitiveness of Polish exports offer finds its real confirmation in the changes of export's geographical structure. The share of highly developed markets (i.e. those whose quality requirements are relatively high) in Polish export rose, during the recent years, by about 5 percentage points. In 2003 it reached almost 75%. The share of the EU markets rose by



11 points, to the level of 69%. During the last two years, the share of the EU markets in Polish exports did not increase. The very fact of stabilization of that share, in a period of very rapid growth of exports – especially in 2003 – should be considered a significant success.

## **9.2. Structure of exports and imports**

Orientation of commodities exchange switched towards highly developed markets, especially of the EU and newly joining members. In 2003, this tendency became more permanent. This brought further, usually favourable, changes in the commodities structure of trade exchange, especially on the export side.

### **9.2.1. Geographical structure**

The year 2003 did not bring more serious changes in the structure of trade exchange. Their direction matches the general long-term trends, such as: increased importance of the EU and CEFTA markets (soon to become the EU markets too) in the Polish export (growth from 77.6% to 78.3%); coupled with a decline of the share of developing countries in export (from 5.9% to 5.6%), and increase of their share in import (from 12.6% to 13%). It is worth noting the share of the CIS markets in export (from 7.2% to 7.0%), coupled with an increase of their share in import (from 9.6% to 9.7%). Decline of the share of these markets in export was due primarily to the slower export to Russia (growth by only 13.6%, which was 20 points slower than the average growth rate of export).

Of the overall amount of exports growth in 2003 (12.6 billion USD), over half was attributed to 5 member countries of the European Union, that is:

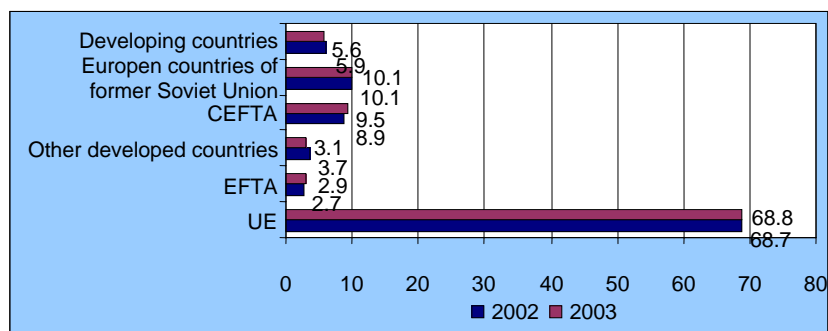
- Germany (increase by more than USD 4 billion, or by 30.4%);
- Italy (increase by USD 820 million, or by 36.4%);
- France (increase by almost USD 800 million, 32.1%);
- Sweden (increase by more than USD 600 million, or by 45.5%); and
- Great Britain (by USD 570 million, or by 26.9%).

Of the overall amount of imports growth in 2003 (USD 12.9 billion), over half was attributed to 5 countries, that is:

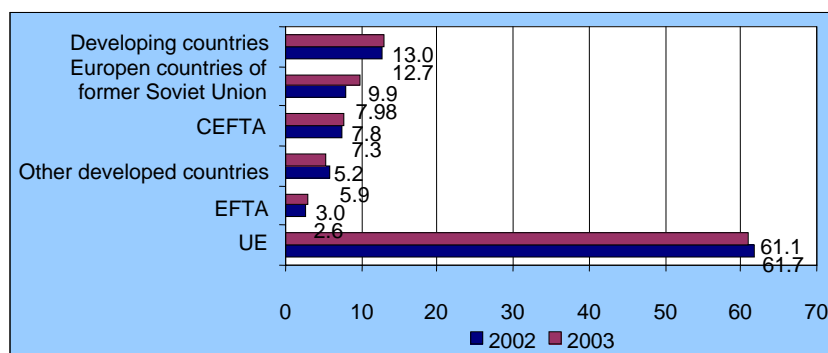
- Germany (increase by USD 3.2 billion, or by 23.7%);
- Italy (increase by USD 1.2 billion, or by 25.5%);
- France (increase by almost USD 1 billion, or by 25.1%);
- Russia (increase by more than USD 800 million, or by 18.6%); and
- China (increase by more than USD 800 million, or by 39.1%).

Chart 24. Geographical structure of Poland's foreign trade turnover in 2003

a) exports



b) imports



Source: Data of the Foreign Trade Research Institute (CIHZ).

### 9.2.2 Commodity structure

Changes of the commodity structure were rather small, and positive changes include the following:

- growth of export of agricultural and food products (from 8.0% to 8.4%), while their share in import went down (from 6.5% to 5.9%). This change can be a proof of Poland's significant potential in the export of agricultural and food products.

- increased share of electromechanical goods (from 38.6% to 39.3%), which reflects the overall trend to modernize the goods offered under Polish export, but also their increased share in overall import (from 39.7% to 40.1%) confirm that there is a high import flexibility of export in that group of commodities.

At the same time, some negative changes have occurred in some other groups, namely:

- metallurgy products, where the share in export dropped from 11.4% to 11.3%, while at the same the share in import rose significantly (from 8.5% to 9.6%) can be tied to the fact that the sector's restructuring does not catch up with the changing structure of market needs;
- products of light industry, primarily textiles and clothing. Their share in turnover was reduced, both on the export side (from 7.8% to 6.8%) and import (from 7.5% to 6.9%). This can be tied to the fact that Polish producers increasingly lose in competition with producers from other countries (such as Ukraine and former Yugoslavia in improvement processing, especially in the clothing sector).
- decline of the share of minerals, primarily coal and its derivatives, in export (from 5.4% to 4.6%), while their share in import stabilized (10.1%) can be seen as the natural consequence of the current trends in the global fuel market. These trends are reflected in decline of demand and prices for coal, and growing popularity of liquid and gas fuels.

### **9.3. General issues of foreign trade**

1. A revival of the commodity exchange with foreign countries, which commenced in mid-2002, was clearly strengthened in 2003. Such a high growth rate of commodities measured in USD (about 30% in export and over 20% on the import side) has not been seen since mid-1990's. Even taking into account the fact, that such high growth of the value of turnover expressed in USD was largely due to a serious depreciation of USD in relation to EUR in 2003 (by about 20%), we can state that the growth rate in 2003, especially in export, was relatively high – both compared to the previous several years

and to the whole period of economic transformation. The extremely high growth rate of export volume, which is estimated at a level close to 19% (on the basis of preliminary and as yet incomplete data of the CSO), coupled with much lower growth rate of import (estimated at less than 10%), became a very important factor determining GDP growth in 2003.

2. Despite a clear revival of commodities exchange, the tendency for gradual balancing of that exchange was maintained, and even strengthened. Reduction of the trade payment deficit in commodities exchange, particularly visible in a conversion to EUR, coupled with a significant increase in the exchange volume, especially in export, can be seen as a new and positive occurrence in Polish foreign trade. It is a proof of improved competitiveness of the Polish economy in the international market, and of gradual alleviation its previous strong dependence on export.
3. Improvement of the balance of commodities turnover, which are the main item of current accounts, was accompanied by a very significant increase of foreign currencies deposits from the so-called unregistered trade. Owing to this, the current account deficit which in 2002 reached the level of USD 6.7 billion—about 3.5% of the GDP – was reduced in 2003 to less than USD 4 billion, which was below 2% of the GDP.
4. The positive results of trade exchange achieved in 2003, both in the official and unregistered trade, were largely due to the clear depreciation trend of PLN in relation to the European currency, which remained in place for the whole year.
5. The relative permanency of that trend, coupled with its relatively high growth rate, was a strong and clear impulse for economic entities to re-focus their activities on export, especially as domestic demand was limited. It is estimated that this change of focus was particularly strong among small and medium-sized entities. Previously, during the period of appreciation of the domestic currency, these firms operated on the verge of profitability, or have not been able at all to compete in terms of prices in the foreign markets. The favourable

exchange rate situation in 2003 made it easier for a large group of these firms to gain and/or increase their presence in these markets, especially in the EU.

6. Regardless of the export-stimulating short term factors named above, 2003 brought further strengthening of the primary conditions for export development; and specifically modernization and improved competitiveness of the Polish commodities offer as a result of direct foreign investments realized in the previous years. The change in export orientation and the related restructuring activities undertaken in 2003 brought many enterprises to a higher level of technology, organization and effectiveness. As a result, these firms have achieved a higher level of export capacity and competitiveness.
7. The relatively high level of export activity in 2003 is largely irreversible. It will result in the maintenance of the high scope of export also in the near future, even if the internal and external conditions become less favourable. This gives grounds for moderately optimistic forecasts on the results of commercial exchange in 2004.

## **Chapter 10**

# **TOURISM**

Tourism is one of the most dynamically developing areas of the global economy. In 2003, tourism accounted for more than 7.5% of the global trade turnover. In more than 80% of countries tourism is considered one of the five most profitable sectors of the economy; and in over 40% it is the most important source of foreign currency for the economy. According to data of the World Tourism Organization, tourism generates over 13% of the global GDP and creates more than 10% of all jobs worldwide.

### **10.1. Situation of tourism in 2003**

According to the latest data of the World Tourism Organization, the total number of global international travels in 2003 was reduced to 694 millions (a decrease by 1.2%). The size of traffic in Europe basically remained unchanged (401.5 million travels, increase by 0.4%).

In Poland, revenues on incoming and domestic tourism became further reduced in 2003. It is estimated that the tourism sector generated in 2003 4.6% of GDP, which is 0.6 percentage point less than in 2002. The reason for such significant decline of the share of that sector in GDP were the reduced revenues on tourism coupled with strong GDP growth (by 3.8%).

#### **10.1.1. Tourists visiting Poland**

In 2003, Poland's borders were crossed by 52.1 million foreigners (tourists and one-day visitors). This was an increase by 2.7% compared to the previous year. The highest increase in their number was recorded at the border with Slovakia, while the largest decrease at the border with the Russian Federation. Since October 2003, visas were introduced on the eastern border, which resulted in a significant reduction in the number of visits. It seems,

however, that the effect of visa introduction may be a bit weaker than originally expected.

The largest increase of arrivals was seen among tourists coming from the following countries: Slovakia (36%), Hungary (23%), Denmark (21%), Spain (20%) and Ireland (19%). The largest increase was recorded among visitors from the following countries: Belgium (30%), the Netherlands (26%), Ukraine (17.5%), Russia (17%), France (11%) and Belarus (10%). The incoming traffic from Germany rose by 7.6%, and the number of arrivals from other EU countries fell by 1.1%.

In 2003 the number of tourists fell by 1.9%, according to the estimates of the Tourism Institute. The average duration of stay grew longer, from 3.9 to 4.1 nights. The German visitors spent on the average 5 nights in Poland, similarly as tourists from other EU countries (4.9). As usual, the shortest stays characterize the neighbours from the East (2.6) and the longest – tourists from non-European countries (12.7). One in ten of them spent over 4 weeks in Poland.

Table 44. Arrivals of foreign tourists into Poland, broken down per country, in the (thousands of arrivals)

| Country                            | 2001   | 2002   | 2003   | Dynamics, % (2003 : 2002) |
|------------------------------------|--------|--------|--------|---------------------------|
| Total tourists, of this:           | 15,000 | 13,980 | 13,720 | 98.1                      |
| Germany                            | 4,400  | 4,160  | 4,520  | 108.7                     |
| Russia, Belarus, Ukraine           | 6,140  | 5,570  | 4,890  | 87.8                      |
| Lithuania, Latvia, Estonia         | 1,360  | 1,320  | 1,320  | 100.0                     |
| Czech Republic and Slovakia        | 310    | 290    | 320    | 110.3                     |
| European Union (excluding Germany) | 1,700  | 1,650  | 1,640  | 99.4                      |

Source: Estimates of the Tourism Institute.

#### 10.1.1.1. Total foreign currency revenues of Poland on incoming tourism

The total foreign currency revenues earned in 2003 on arrivals of foreigners to Poland were lower by 9.4% from revenues earned in 2002. Reduction of revenues was seen both in the case of tourists and one-day visitors. The structures of revenues underwent a favourable change: the share of tourists rose to 66.2% (by 3.8 points) at the cost of one- day visitors.

Table 45. Foreign currency revenues on the visits of foreigners (USD million)

|                  | 2002  | 2003  | Dynamics, % (2003:2002) |
|------------------|-------|-------|-------------------------|
| Tourists         | 2,805 | 2,692 | 96.0                    |
| One-day visitors | 1,688 | 1,377 | 81.6                    |
| TOTAL            | 4,493 | 4,069 | 90.6                    |

Source: Estimates of the Tourism Institute and NBP.

The average expenses of foreign tourists for their whole stay in Poland reached in 2003 the level of about USD 115 per person (a decline by 13.6%), and USD 24 per one day of visit (weighted averages).

Spending per person ranged from USD 70 (Lithuanian tourists) to USD 265 (overseas visitors).

The average daily spending of tourists ranged from about USD 20 (visitors from overseas and Belgium, Germany and France) to USD 30 (visitors from Austria, Italy). In 2003, a decrease of spending per one day of visit was seen among visitors from most countries. Lithuanians increased their daily spending, while Russians kept theirs on the same level.

#### 10.1.2. Domestic tourism of Poles

In 2003, the number of Poles aged 15 and over participating in tourist travels fell.

Table 46. Number of domestic travels of Poles aged 15 and over (millions)

|                            | 2001 | 2002 | 2003 | Change 03/02 |
|----------------------------|------|------|------|--------------|
| Domestic long-term         | 10.1 | 10.4 | 10.0 | -3.8         |
| Domestic short-term        | 10.6 | 10.9 | 9.7  | -11.0        |
| Total domestic             | 16.0 | 16.5 | 15.8 | -4.2         |
| Foreign long-term          | 3.6  | 3.6  | 2.6  | -27.8        |
| Foreign short-term         | 1.0  | 1.2  | 1.0  | -16.7        |
| Foreign (total)            | 4.4  | 4.4  | 3.3  | -25.0        |
| Total domestic and foreign | 17.7 | 17.8 | 17.0 | -4.5         |

Source: Research of the Tourism Institute.

According to the estimates of the Tourism Institute, in 2003 Poles aged 15 and over participated in 48.4 millions of domestic tourist travels. Of this total number, one third (36%) were long-term travels of at least 5 days; and short-term



travels (2–4 days, but with at least one night spent outside the place of residence) – 64%. The total number of travels was reduced by 10.7%, and much higher reduction occurred in short-term travels than in long-term ones.

Table 47. Domestic travels of Poles aged 15 and over (in millions)

|                | 2001 | 2002 | 2003 | Change 03/02 |
|----------------|------|------|------|--------------|
| Long-term      | 17.4 | 18.0 | 17.2 | –4.4%        |
| Short-term     | 36.4 | 36.2 | 31.2 | –13.8%       |
| Total domestic | 53.8 | 54.2 | 48.4 | –10.7%       |

Source: Estimates on the basis of questionnaires of the Tourism Institute.

Revenues on domestic tourism (including expenses for children tourist travel) amounted to PLN 21.7 billion in 2003, which was 4.4% less than the result of 2002.

### 10.1.3. Foreign travels of Poles

In 2003, Poles took part in 7.2 million foreign tourist travels – defined as travels including at least one night outside the country's boundaries. The number of travels dropped by 14.3%.

Polish tourists most frequently visited Germany, Italy, the Czech Republic, Slovakia and Austria. Among the countries most frequently visited by Poles, an increase in the number of Polish tourists compared to 2002 was recorded in Italy and Austria. The largest decline was seen in Greece (by over 70%), Spain (50%) and the Netherlands (over 40%), and smaller ones in the case of France and Croatia. Interest in travels to Russia and Egypt has grown.

### 10.1.4. Tourist accommodation premises in Poland

Among all types of tourist accommodation premises, the most numerous are holiday resorts, hotels and unclassified premises. The seasonal usage of resources improved, because the number of accommodation available all year round rose by about 5.1%. According to data of the CSO, in 2003 the number of mass accommodation premises rose slightly – by 0.9% compared to the previous year. It is worth to stress that the number of hotels rose by almost 8%. As the rules for categorizing accommodation premises are applied in a very strict manner, a large number of premises is included in the „other unclassified” group. In 2003, their number rose by 3%, compared to 2002.

In 2003, the number of persons using mass accommodation rose by 3.% and the increase was faster among foreign tourists. The number of persons staying at hotels increased particularly rapidly.

The number of overnight stays rose by 2.6%, more in hotels than in other centres. The dynamics of accommodation services provided to foreign tourists was much bigger than with respect to Polish tourists.

Table 48. The usage of collective tourist accommodation premises in 2002 and 2003 (thousand)

|                       | Total  |        | of this |        |                |        | Dynamics (%) |         |         |
|-----------------------|--------|--------|---------|--------|----------------|--------|--------------|---------|---------|
|                       |        |        | hotels  |        | other premises |        |              |         |         |
|                       | 2002   | 2003   | 2002    | 2003   | 2002           | 2003   | (3 : 2)      | (5 : 4) | (7 : 6) |
| 1                     | 2      | 3      | 4       | 5      | 6              | 7      | 8            | 9       | 10      |
| The users:            | 14,174 | 14,644 | 6,431   | 6,864  | 7,743          | 7,780  | 103,3        | 106,7   | 100,5   |
| – domestic tourists   | 11,029 | 11,312 | 3,984   | 4,252  | 7,045          | 7,060  | 102,6        | 106,7   | 100,2   |
| – foreign tourists    | 3,145  | 3,332  | 2,447   | 2,612  | 698            | 720    | 105,9        | 106,7   | 103,2   |
| Provided accomodation | 44,212 | 45,348 | 11,598  | 12,653 | 32,614         | 32,695 | 102,6        | 109,1   | 100,2   |
| domestic tourists     | 37,127 | 37,520 | 6,814   | 7,414  | 30,313         | 30,106 | 101,1        | 108,8   | 99,3    |
| foreign tourists      | 7,085  | 7,828  | 4,784   | 5,239  | 2,301          | 2,589  | 110,5        | 109,5   | 112,5   |

Source: Statistical Bulletin of the CSO no. 5/2004.

During the 1<sup>st</sup> quarter of 2004, 11.5 million of foreigners coming into Poland were recorded. This is 19.8% more than during the same period of 2003. Reductions in traffic were recorded only on the borders with Ukraine, Belarus and the Russian Federation (by 14.8%, 14.5% and 11.5%, respectively). Growth tendency is still present on the borders with Slovakia and Germany. The number of foreigners at airports increased significantly, by 16.6%.

Together with the increase of incoming travels, the level of expenses made in Poland by non-residents also rose. This applies both to tourists and the one-day visitors.

A positive element is an increase of average spending per visitor (both among tourist and one-day visitors), and the increase of average spend per one day of stay. If these tendencies are not stopped in later period of the year, we can expect an increase of Poland's foreign currency revenues tied to arrivals of foreigners. Still, it would be caused more by shopping expenses than typically tourist expenses.

According to the estimates of the Tourism Institute, in the 1<sup>st</sup> quarter of 2004, Poles participated in 7.2 millions of domestic tourist travels. A 13% decrease was registered in the total number of domestic travels, compared to the 1<sup>st</sup> quarter of 2003. In the 1<sup>st</sup> quarter of 2004, Poland's borders were crossed by less than 7.9 millions of Poles going to other countries. This is a decline of 4.3%, compared to the same period of last year.

## **10.2. General issues of tourism**

The factors which exerted the strongest influence on the worsening of indices regarding tourists incoming to Poland, tourist activity of Poles and revenues on tourism, include primarily:

- lack of a clear improvement of the global economic situation, and in particular, the strong cooling off of German economy, which is Poland's principal partner in tourism;
- difficult situation in the labour market and in social security (high unemployment and reduction of social benefits cause the relative reduction of income, which in turn reduces the motivation of Polish families to spend money on tourism);
- lack of international security (such events as the terrorist attack on WTC of 11 September 2001, or preparations for war in Iraq),
- a drop in competitiveness of the Polish offer as the level of service is not matched to prices,
- insufficient funds allocated for the promotion of Poland as a country attractive for tourists,
- poor accessibility of the main tourist regions, caused by insufficient number of international airline connections to regions,
- low quality of roads and services for motor tourists, lack of expressways and highways,
- reduction of the so-called cross-border traffic for commercial purposes (reduction of foreign currency revenues caused by a high exchange rate of PLN and recent introduction of visas).

## Chapter 11

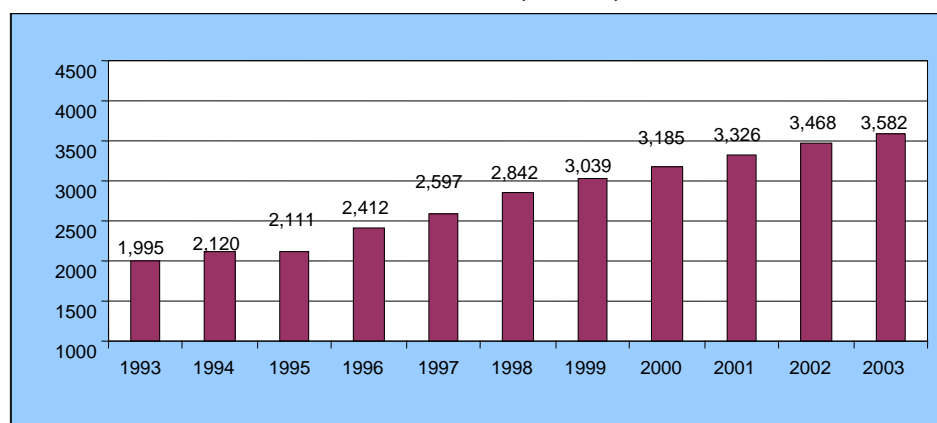
# ENTERPRISES

### 11.1. Changes in the number of business entities

The process of ownership changes which have been occurring in Poland since the start of the 1990's caused gradual changes, both in terms of the number of business entities and in their ownership structure. The changes have been realized in the creation of many new private business entities, and in the privatization of the assets of the former state sector.

At the end of 2003, there were 3,581,593 business entities active in Poland – including firms owned by individuals. This is an increase of 3.3%, compared to 2002.

Chart 25. Number of business entities in 1993–2003 (thousand)



Source: CSO, *Structural changes in the groups of entities of the national economy in 2003*.

In the private sector there were 3,452,278 entities (growth by 3.1%), and in the public sector 129,315 entities (growth by 7.2%). A higher growth dynamics of entities in the public sector is not a result of establishment of new entities. It is caused by organizational changes in the education, health services and culture

sectors, as the government administration passes the tasks tied to public education, health protection, social assistance and culture to local authorities. The entities taken over by local authorities are made independent, and they are listed in the register of entities managed by the Central Statistical Office (before, as units of the governmental administration, they were not taken into account in the statistics of the CSO). As regards absolute figures, a much higher increase is found in the private sector, despite lower dynamics.

Among the total number of business entities, the largest groups are firms owned by individuals (78.1%), civil partnerships (7.8%) and commercial companies (5.8%).

In 2003, increases occurred in the groups of commercial companies, other companies (i.e. operating on the basis of regulations other than the Code of Commercial Companies and the Civil Code), and firms owned by individuals.

**Table 49. Changes in the number of entities with various organizational and legal forms in 1998–2003**

| Description<br>a – number of entities<br>b – dynamics |   | status at<br>31.12.1998 | status at<br>31.12.1999 | status at<br>31.12.2000 | status at<br>31.12.2001 | status at<br>31.12.2002 | status at<br>31.12.2003 |
|---|---|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| TOTAL   | a | 2,842,278               | 3,039,451               | 3,185,040               | 3,325,540               | 3,468,218               | 3,581,593               |
|   | b | 109.4                   | 106.9                   | 104.8                   | 104.4                   | 104.3                   | 103.3                   |
| Public sector   | a | 69,729                  | 83,306                  | 98,917                  | 110,910                 | 120,593                 | 129,315                 |
|   | b | 121.8                   | 119.5                   | 118.7                   | 112.1                   | 108.7                   | 107.2                   |
| Private sector  | a | 2,772,549               | 2,956,145               | 3,086,123               | 3,214,630               | 3,347,625               | 3,452,278               |
|   | b | 109.2                   | 106.6                   | 104.4                   | 106.3                   | 104.1                   | 103.1                   |
| State-owned enterprises                               | a | 2,906                   | 2,599                   | 2,268                   | 2,054                   | 1,951                   | 1,736                   |
|   | b | 86.3                    | 89.4                    | 87.3                    | 90.6                    | 95.0                    | 89.0                    |
| Commercial companies                                  | a | 136,497                 | 146,859                 | 159,660                 | 177,085                 | 196,681                 | 208,753                 |
|   | b | 107.9                   | 107.6                   | 108.7                   | 110.9                   | 111.1                   | 106.1                   |
| Civil partnerships                                    | a | 272,008                 | 288,956                 | 302,717                 | 290,890                 | 280,547                 | 279,208                 |
|   | b | 110.8                   | 106.2                   | 104.8                   | 96.1                    | 96.4                    | 99.5                    |
| Other companies                                       | a | 1,507                   | 1,561                   | 1,641                   | 1,681                   | 1,744                   | 1,777                   |
|   | b | 108.8                   | 103.6                   | 105.1                   | 102.4                   | 103.7                   | 101.9                   |
| Cooperatives  | a | 19,638                  | 19,328                  | 19,011                  | 18,812                  | 18,682                  | 18,548                  |
|   | b | 99.3                    | 98.4                    | 98.4                    | 99.0                    | 99.3                    | 99.3                    |
| Individual-owned firms                                | a | 2,274,493               | 2,417,737               | 2,500,952               | 2,666,855               | 2,714,118               | 2,795,860               |
|   | b | 108.8                   | 106.3                   | 103.4                   | 106.6                   | 104.4                   | 103.0                   |

Source: CSO, *Structural changes in the groups of economic entities in 2003*.

At the end of 2003 there were 1,736 state-owned entities, i.e. by 215 less than a year before. A drop in the number of state-owned entities is a result of

privatization processes. Also the number of co-operatives fell (by 0.7%), as well as civil partnerships (by 0.5%).

In 2003, the total number of business entities rose across all areas of the economy. The largest dynamics was seen in agriculture and related sections, real estate services, hotels and restaurants. In the total structure of entities, the largest groups are: commerce and repairs (33.5%), industry (10.8%) and construction (10.1%).

**Table 50. National economy entities by CPA section**

| Description<br>a - 12-31-2002<br>b - 12-31-2003<br>c - dynamics |   | Total     | Of which:                          |           |                                   |                               |                        |   |
|---|---|-----------|------------------------------------|-----------|-----------------------------------|-------------------------------|------------------------|---|
|   |   |           | State<br>owned<br>entre-<br>prises | Companies |                                   |                               | co-<br>opera-<br>tives | natural<br>persons<br>conduct-<br>ing<br>economic<br>activity |
|   |   |           |                                    | total     | com-<br>mercial<br>compa-<br>nies | civilian<br>part-<br>nerships |                        |   |
| Grand total   | a | 3,468,218 | 1,951                              | 478,972   | 196,681                           | 280,547                       | 18,682                 | 2,714,118   |
|   | b | 3,581,593 | 1,736                              | 489,738   | 208,753                           | 279,208                       | 18,548                 | 2,795,860   |
| of which  | c | 103.3     | 89.0                               | 102.2     | 106.1                             | 99.5                          | 99.3                   | 103.0   |
| Agriculture, hunting, forestry<br>and fishing                   | a | 93,677    | 33                                 | 8,466     | 3,767                             | 3,595                         | 3,367                  | 77,827  |
|   | b | 102,084   | 27                                 | 8,698     | 3,946                             | 3,618                         | 3,289                  | 86,066  |
|   | c | 109.0     | 81.8                               | 102.7     | 104.8                             | 100.6                         | 97.7                   | 110.6   |
| Industry  | a | 382,948   | 883                                | 83 872    | 43 044                            | 40 591                        | 2 208                  | 294 968   |
|   | b | 387,315   | 787                                | 85 599    | 45 356                            | 40 004                        | 2 179                  | 297 650   |
|   | c | 101.1     | 89.1                               | 102.1     | 105.4                             | 98.6                          | 98.7                   | 100.9   |
| Construction  | a | 357,597   | 345                                | 45,239    | 21,222                            | 23,777                        | 922                    | 310,784   |
|   | b | 360,600   | 307                                | 45,366    | 21,882                            | 23,247                        | 915                    | 313,748   |
|   | c | 100.8     | 89.0                               | 100.3     | 103.1                             | 97.8                          | 99.2                   | 101.0   |
| Trade and repair  | a | 1,168 108 | 229                                | 200,017   | 72,353                            | 127,663                       | 3,394                  | 963,682   |
|   | b | 1,199 688 | 200                                | 202,919   | 76,622                            | 126,297                       | 3,351                  | 992,422   |
|   | c | 102.7     | 87.3                               | 101.5     | 105.9                             | 98.9                          | 98.7                   | 103.0   |
| Hotels and restaurants  | a | 105,880   | 11                                 | 18,902    | 3,738                             | 15,164                        | 42                     | 86,375  |
|   | b | 112,079   | 10                                 | 19,671    | 4,161                             | 15,510                        | 40                     | 91,596  |
|   | c | 105.9     | 90.9                               | 104.1     | 111.3                             | 102.3                         | 95.2                   | 106.0   |
| Transport, storage and<br>communication                         | a | 267,130   | 257                                | 21,240    | 8,617                             | 12,623                        | 248                    | 245,023   |
|   | b | 269,947   | 228                                | 22,311    | 9,455                             | 12,856                        | 245                    | 246,763   |
|   | c | 101.1     | 88.7                               | 105.0     | 109.7                             | 101.8                         | 98.8                   | 100.7   |
| Financial intermediation  | a | 123,885   | 2                                  | 7,105     | 3,669                             | 3,430                         | 976                    | 114,793   |
|   | b | 127,630   | 2                                  | 7,509     | 4,005                             | 3,496                         | 942                    | 118,092   |
|   | c | 103.0     | 100.0                              | 105.7     | 109.2                             | 101.9                         | 96.5                   | 102.9   |
| Real estate, renting and<br>business activities; science        | a | 514,125   | 181                                | 66,151    | 31,876                            | 34,259                        | 7,241                  | 353,141   |
|   | b | 546,042   | 167                                | 68,687    | 34,142                            | 34,527                        | 7,306                  | 371,078   |
|   | c | 106.2     | 92.3                               | 103.8     | 107.1                             | 100.8                         | 100.9                  | 105.1   |

Source: CSO, *Structural changes in the groups of economy entities in 2003*.

Companies with the majority share of domestic private capital dominate the group of commercial companies, and their number rose by 6.6% in 2003. Domestic private entrepreneurs usually manage business activity as a limited liability company. These companies constitute 82.9% of the total number of companies where private domestic capital is involved. A similar trend is present among commercial companies with foreign capital, where limited liability companies constitute 97%. The total number of commercial companies with foreign capital rose by 3.4% in 2003.

In terms of regional breakdown, the largest number of business entities as the end of 2003 was found in the Mazowieckie province (16.1%) and Silesian (11.8%), and the smallest – in Opolskie (2.4%) and Podlaskie provinces (2.7%).

**Table 51. Commercial companies by capital ownership and legal status**

| a – 2002<br>b – 2003<br>c – 2002 = 100 |             | Total                       | By type of capital     |                            |                        |                                |                             |                           |
|--|-------------|-----------------------------|------------------------|----------------------------|------------------------|--------------------------------|-----------------------------|---------------------------|
|  |             |                             | State Treasury         |                            | state owned            | local self-government entities | private                     | foreign                   |
|  |             |                             | total                  | of which: sole-shareholder |                        |                                |                             |                           |
| Total                                  | a<br>b<br>c | 196,681<br>208,753<br>106.1 | 2,335<br>2,264<br>97.0 | 721<br>688<br>95.4         | 5,157<br>4,974<br>96.5 | 2,524<br>2,583<br>102.3        | 165,956<br>176,956<br>106.6 | 47,352<br>48,973<br>103.4 |
| Joint stock companies                  | a<br>b<br>c | 8,609<br>8,641<br>100.4     | 1,428<br>1,370<br>95.9 | 469<br>434<br>92.5         | 748<br>718<br>96.0     | 362<br>364<br>100.6            | 7,440<br>7,490<br>100.7     | 1,315<br>1,356<br>103.1   |
| Limited liability companies            | a<br>b<br>c | 169,022<br>177,380<br>104.9 | 904<br>891<br>98.6     | 252<br>254<br>100.8        | 4,390<br>4,235<br>96.5 | 2,159<br>2,216<br>102.6        | 139,492<br>146,767<br>105.2 | 45,980<br>47,522<br>103.4 |
| Professional partnerships              | a<br>b<br>c | 418<br>581<br>139.0         |                        |                            |                        |                                | 418<br>581<br>139.0         |                           |
| Unlimited partnerships                 | a<br>b<br>c | 17,978<br>21,370<br>118.9   | 2<br>2<br>100.0        |                            | 13<br>14<br>107.7      | 2<br>2<br>100.0                | 17,968<br>21,358<br>118.9   | 22<br>35<br>159.1         |
| Limited partnerships                   | a<br>b<br>c | 645<br>763<br>118.3         | 1<br>1<br>100.0        |                            | 6<br>7<br>116.7        | 1<br>1<br>100.0                | 629<br>742<br>118.0         | 35<br>60<br>171.4         |
| Joint stock- limited partnerships      | a<br>b<br>c | 9<br>18<br>200.0            |                        |                            |                        |                                | 9<br>18<br>200.0            |                           |

Note: Total number of companies by capital ownership is not equal to the total number of all companies, as companies with mixed capital appear in two or more columns of the table, depending on the capital engaged.

Source: CSO, *Structural changes in the groups of economic entities in 2003*.

From the perspective of the number of employees, the dominant form is constituted by entities with less than 10 workers. Their share in the total number of business entities amounted 95.2%, similarly as in 2002. 97.7% of such firms function in the private sector.

**Table 52. Economic entities by the number of persons employed.**

| The number of employed persons | Total     | Public sector | Private sector | Of which: natural persons conducting economic activity |
|--------------------------------|-----------|---------------|----------------|--|
| 0–9                            | 3,410,233 | 77,632        | 3,332,601      | 2,757,749  |
| 10–49                          | 137,974   | 38,076        | 99,898         | 35,645   |
| 50–249                         | 28,329    | 11,249        | 17,080         | 2,362  |
| 250–999                        | 4,153     | 1,821         | 2,332          | 94   |
| over 1000                      | 904       | 537           | 367            | 10   |
| Total                          | 3,581,593 | 129,315       | 3,452,278      | 2,795,860  |

*Source: CSO, Structural changes in the groups of economic entities in 2003.*

## 11.2. Financial situation of the enterprise sector

In 2003, the financial and economic situation of business entities improved significantly. Revenues from the overall activity rose faster than the costs (measured in current prices). The financial results and all economic and financial indices, which characterize business entities, improved. The main factors determining this improvement include:

- acceleration of the economic growth,
- dynamic growth of sold industrial output which, through the effect of scale, caused a relatively stable costs to be spread over much larger production volume, which resulted in reduction of unit costs,
- increase of the prices of the sold industrial output,
- Increased labour effectiveness in industry, coupled with a decline of employment,
- reduction of debts of the hard coal mining sector.

The factor, which accelerated the growth of revenues, was export, stimulated by the falling value of PLN (especially against EUR). A relative increase of reve-



nues from export sales was almost twice as fast as the growth of overall revenues, and the share of export sales in revenues from basic business rose to 15.6%. Only in the construction sector, which production is closely tied to the dynamics and size of investment, a decline of revenues was recorded.

An increase of the internal demand was also observed, which enabled producers to raise prices. Dynamics of prices of the sold industrial output was higher than in 2002, causing an increase of revenues, which are recorded in current prices.

A high growth of labour productivity occurred, achieved under the conditions of reduction of employment and moderate growth of salaries. The dynamics of personnel costs was much lower than the dynamics of total costs, which resulted in a reduction of the share of personnel costs in the cost categories.

In 2003, the government cancelled liabilities of the hard coal mining sector, amounting to the total of PLN 18.1 billion. Of that, PLN 13.2 billion constituted balance sheet liabilities. The cancelled balance sheet liabilities increased the revenues on other operating activity and financial revenues (without the corresponding increase in costs). This caused a respective increase of the gross and net financial results (profits on the cancelled liabilities were exempt from levies for the state budget). Debt reduction for the mining sector had a significant influence on the financial results, ratios of profitability and liquidity, and on the volume of debts, in the following aggregates: overall economy, industry, the mining and quarrying section, and the public sector. In these aggregates the financial results and indices of profitability and liquidity improved significantly. The improvement was largely of statistical, not effective, nature. It was not accompanied with an increased flow of funds or increase in receivables. The debt cancellation of the mining sector did not influence financial results in other aggregates. Other aggregates saw an effective improvement of financial results as well as indices of profitability and liquidity.

A slight increase of debts was seen in the whole economy, caused by cancellation of debts for the coal-mining sector. The dynamics of debts was much lower than the dynamics of revenues, which caused an improvement of relations tied to debt, and financial liquidity of businesses. In the mining and quarrying sector debt was reduced by almost 50%.

### **11.2.1. Revenues and deductible costs**

In 2003, research of the CSO covered 40,392 business entities submitting financial statements, including 15,473 medium-sized and large entities<sup>45</sup>. From the perspective of number of researched entities, industry is the dominant sector (14,988 firms). 37,107 entities functioned in the private sector.

Revenues from overall activity rose by 12.0% compared to 2002. It has to be pointed out, though, that both the dynamics of revenues from overall activity and changes in the structure of these revenues cannot be subject to an objective analysis. Revenues achieved in 2003 are not fully comparable to those from 2002. This is caused by debt cancellation of the hard coal mining sector. This issue is discussed in more detail in the Report on Industry.

The fastest growth was recorded in trade, and the second largest in industry. A relative increase of revenues in small industrial entities was much faster than in medium-sized and large ones. This situation is caused by the debt reduction of the coal mining sector. Only in the construction sector, whose production and revenues volumes are closely tied to the dynamics and size of investment, a decline of revenues was recorded. Industry and trade dominate the structure of revenues. The share of these sectors constituted 48.8% and 32.7%, respectively.

In the private sector, an increase of revenues was faster than in the public sector. The share of the private sector in the overall revenues rose from 79.1% to 79.3%. The most privatized sectors include construction and commerce, where the share of the private sector in the overall revenues exceeds 93%.

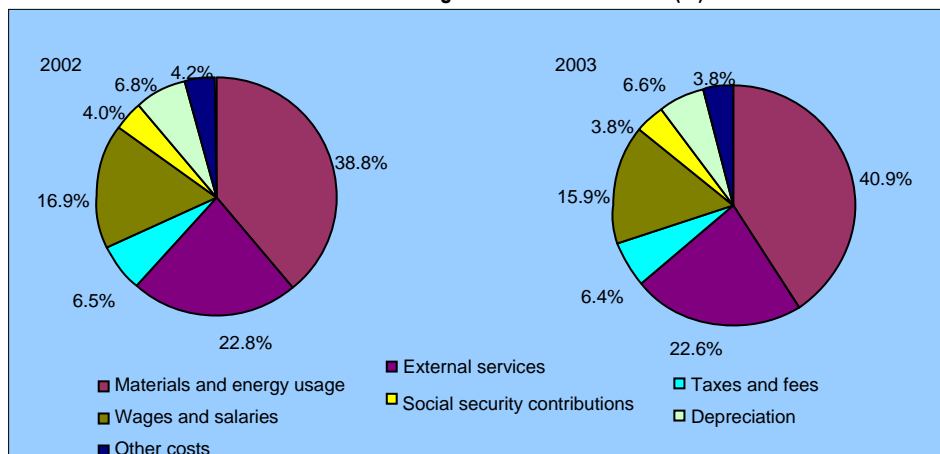
The dynamics of revenues exceeded the dynamics of deductible costs by 2.9 percentage points, resulting in improvement of financial results and the economic and financial indices. This situation occurred in all presented aggregates.

### **11.2.2. Cost categories**

Costs in all categories rose by 8.3%. The increase in the private sector amounted to 10.1%.

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<sup>45</sup> The CSO presents data for entities preparing full financial statements, whose number of workers exceeds 9 persons. For the purpose of this chapter, small enterprises are defined as firms with 10 to 49 employees, and medium-sized and large ones are entities with more than 49 employees.

**Chart 26. The structure of overall costs categories in 2002 and 2003\* (%)**

\* business entities employing more than 49 workers

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of CSO study „Financial results of business entities, January – December 2002 and 2003“.

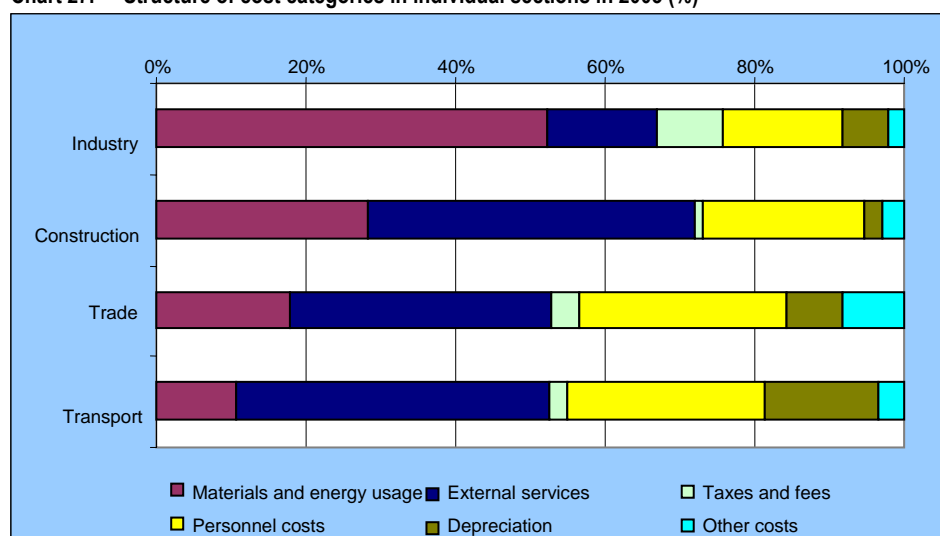
The costs of materials and energy usage were the only ones, which grew faster than the average. Other items of cost categories rose at a slower rate, with the exception of the item „other costs“, which dropped in terms of absolute values. In consequence, only the share of costs of materials and energy usage rose in the structure of cost categories. The higher share of material costs results from higher share of the private sector in overall costs (from 75.0% to 76.2%). The share of material costs in the private sector is much higher than in the public sector.

The relatively small increase of salaries and related costs, under situation of a relatively high increase of overall costs, resulted in a reduction of the share of personnel costs in the costs structure. The reason for the change was the growth of labour productivity (growth of GDP occurred under reduced employment levels).

There are significant differences in the structure of cost categories, both among the ownership sectors and the individual areas of business activity. In the private sector, the share of costs of materials usage and „other costs“ is much higher than in the public sector, which in turn has a higher share of other cost items. The differences are particularly high in the case of personnel costs and depreciation. The public sector continues to dominate in the so-called heavy

industry (mining, power sector) which is characterized by much higher capital consumption. This leads to increased share of depreciation in the costs. Employees of the heavy industry sectors obtained certain salary privileges, back before the transformation, which until today result in the relatively high share of personnel costs. At the same time, it should be stressed that the salary differences become flattened with time.

**Chart 27. Structure of cost categories in individual sections in 2003 (%)\***



\* entities with more than 49 employees

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January – December 2002 and 2003”.

### 11.2.3. Gross financial result

The gross financial result rose almost five times; and the increase in small enterprises was almost nine-fold. High dynamics in these entities is a result of debt cancellation for the hard coal mining sector, and its organizational restructuring.

In large and medium sized entities, gross financial result reached PLN 30.2 billion. Of that, gross profit amounted to PLN 50.2 billion (increase by 38.9%), and gross losses – PLN 20.1 billion (decrease by 30.5%)<sup>46</sup>.

<sup>46</sup> Lack of data for the whole analyzed group.

Improvement occurred in all areas of activity. In terms of absolute values, the largest increase was seen in industry and amounted to 63.5% of the overall increase of gross result. Industry participated in 67.4% of the overall gross result.

In the private sector, the result rose by PLN 17.8 billion, and in the public sector – by PLN 14.7 billion. A significant improvement in the public sector is due primarily to the debt reduction of hard coal mining sector. The share of the private sector in the gross results constituted 73.9% in 2003.

**Table 53. Gross financial result in the years 2002 and 2003 (in million PLN)**

| Item | Description                          | Gross financial result in million zloty |                |               |        |                |               | Dynamics in % |         |         |
|------|--------------------------------------|---|----------------|---------------|--------|----------------|---------------|---------------|---------|---------|
|      |                                      | 2002                                    |                |               | 2003   |                |               |               |         |         |
|      |                                      | Total                                   | of this        |               | Total  | of this        |               | (6 : 3)       | (7 : 4) | (8 : 5) |
|      |                                      |   | private sector | public sector |        | private sector | public sector |               |         |         |
| 1    | 2                                    | 3                                       | 4              | 5             | 6      | 7              | 8             | 9             | 10      | 11      |
| 1    | TOTAL, of this:                      | 8,494                                   | 12,509         | -4,016        | 41,040 | 30,344         | 10,696        | 483.2         | 242.6   | x       |
| 2    | – medium-sized and large entities    | 7,312                                   | 11,286         | -3,974        | 30,176 | 26,366         | 3,810         | 412.7         | 233.6   | x       |
| 3    | – small entities                     | 1,182                                   | 1,223          | -42           | 10,864 | 3,978          | 6,886         | 919.1         | 325.3   | x       |
| 4    | Industry                             | 6,988                                   | 9,470          | -2,482        | 27,662 | 18,576         | 9,086         | 395.9         | 196.2   | x       |
| 5    | – medium-sized and large entities    | 6,067                                   | 8,520          | -2,453        | 22,295 | 17,476         | 4,819         | 367.5         | 205.1   | x       |
| 6    | – small entities                     | 921                                     | 950            | -29           | 5,367  | 1,100          | 4,267         | 582.7         | 115.8   | x       |
| 7    | Construction                         | -826                                    | -641           | -185          | 409    | 572            | -163          | x             | x       | 88.1    |
| 8    | – medium-sized and large entities    | -833                                    | -646           | -187          | 114    | 277            | -163          | x             | x       | 87.2    |
| 9    | – small entities                     | 7                                       | 5              | 2             | 295    | 295            | 0             | 4,214.3       | 5,900.0 | x       |
| 10   | Commerce and repairs                 | 2,309                                   | 3,001          | -692          | 4,928  | 5,531          | -603          | 213.4         | 184.3   | 87.1    |
| 11   | – medium-sized and large entities    | 641                                     | 1,311          | -670          | 2,686  | 3,290          | -604          | 419.0         | 251.0   | 90.1    |
| 12   | - small entities                     | 1,668                                   | 1,690          | -22           | 2,242  | 2,241          | 1             | 134.4         | 132.6   | x       |
| 13   | Transport, storage and communication | -1,279                                  | 337            | -1,616        | 2,987  | 4,147          | -1,160        | x             | 1,230.6 | 71.8    |
| 14   | – medium-sized and large entities    | 595                                     | 2,221          | -1,626        | 2,912  | 4,095          | -1,183        | 489.4         | 184.4   | 72.8    |
| 15   | – small entities                     | -1,874                                  | -1,884         | 10            | 75     | 52             | 23            | x             | x       | 230.0   |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January – December 2002 and 2003“.

Note: Shaded fields contain dynamics of negative values.

#### 11.2.4. Net financial result

In 2003, a significant improvement of the net financial result was registered. In terms of absolute values, it reached PLN 29.4 billion. This allowed for a change of the net financial result – from negative in 2002 to positive in 2003. The improvement was largely due to the debt reduction of hard coal mining sector. In large and medium-sized entities, net result reached PLN 18.0 billion. It consisted of net profits of PLN 38.0 billion (an increase of 42.6%); and of net losses of PLN 20.0 billion (decrease of 30.1%).<sup>47</sup>

The net results improved in all analyzed areas of operations. Despite the improvement, the result in construction sector remained negative. The largest absolute growth occurred in industry (PLN 18.1 billion). The share of that area in the overall result for 2003 reached 72.0%. It should be remembered, however, that the main factor determining improvement was the debt reduction of the coal mining sector.

In the private sector, the net financial result rose by PLN 15.8 billion; and in the public sector (influenced by the debt cancellation of the coal-mining sector) – by PLN 13.6 billion. The share of the private sector in the net result accounted for 72.3%.

Among the non-financial business entities, the highest net profits<sup>48</sup> were achieved by: the coal mining company Katowicki Holding Węglowy S.A. (PLN 1,395 million), PKN Orlen S.A. (PLN 1,069 million), Telekomunikacja Polska S.A. (PLN 912 million), the coal mining company Jastrzębska Spółka Węglowa S.A. (PLN 897 million) and Polkomtel S.A. (PLN 747 million). The list comprises two coal-mining companies, where high profits are an outcome of the debt cancellation process. The ranking of enterprises according to net profits would have been dominated by entities from the coal-mining sector, if other companies could show appropriately high sales revenues (the list includes 500 largest firms, measured in terms of sales revenues). However, as coal mines were transferred on 1 February 2003 to the Kompania Węglowa holding, sales of coal in these companies was reported only for January 2003, so the revenues were small. As an illustration, in the individual companies the net profit amounted to: in the Nadwiślańska

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<sup>47</sup> Lack of data for the whole analyzed group.

<sup>48</sup> The list of 500 enterprises on the basis of data from the *Rzeczpospolita* daily, issue from 15 April 2004.

SW S.A. PLN 2,406 million; in Rybnicka SW S.A. – PLN 1,749 million; in Gliwicka SW S.A. – PLN 1,533 million and in Rudzka SW S.A. – PLN 1,133 million.

**Table 54. Net financial result in 2002 and 2003**

| Item | Description                       | Net financial result in million zloty |                |               |        |                |               | Dynamics in % |         |         |
|------|-----------------------------------|---------------------------------------|----------------|---------------|--------|----------------|---------------|---------------|---------|---------|
|      |                                   | 2002                                  |                |               | 2003   |                |               |               |         |         |
|      |                                   | Total                                 | of this:       |               | Total  | of this:       |               | (6 : 3)       | (7 : 4) | (8 : 5) |
|      |                                   |                                       | private sector | public sector |        | private sector | public sector |               |         |         |
| 1    | 2                                 | 3                                     | 4              | 5             | 6      | 7              | 8             | 9             | 10      | 11      |
| 1    | TOTAL, of this:                   | -2,208                                | 3,855          | -6,063        | 27,197 | 19,677         | 7,520         | x             | 510.4   | x       |
| 2    | – medium-sized and large entities | -1,960                                | 3,994          | -5,954        | 17,987 | 17,311         | 676           | x             | 433.4   | x       |
| 3    | – small entities                  | -248                                  | -139           | -109          | 9,210  | 2,366          | 6,844         | x             | x       | x       |
| 4    | Industry                          | 1,496                                 | 5,011          | -3,515        | 19,576 | 12,730         | 6,846         | 1,308.6       | 254.0   | x       |
| 5    | – medium-sized and large entities | 976                                   | 4,434          | -3,458        | 14,654 | 12,063         | 2,591         | 1,501.4       | 272.1   | x       |
| 6    | – small entities                  | 520                                   | 577            | -57           | 4,922  | 667            | 4,255         | 946.5         | 115.6   | x       |
| 7    | Construction                      | -1,274                                | -1,072         | -202          | -90    | 93             | -183          | 7.1           | x       | 90.6    |
| 8    | – medium-sized and large entities | -1,180                                | -979           | -201          | -245   | -65            | -180          | 20.8          | 6.6     | 89.6    |
| 9    | – small entities                  | -94                                   | -93            | -1            | 155    | 158            | -3            | x             | x       | 300.0   |
| 10   | Commerce and repairs              | 281                                   | 1,043          | -762          | 2,522  | 3,209          | -687          | 897.5         | 307.7   | 90.2    |
| 11   | – medium-sized and large entities | -749                                  | -14            | -735          | 980    | 1 659          | -679          | x             | x       | 92.4    |
| 12   | – small entities                  | 1,030                                 | 1,057          | -27           | 1,542  | 1,550          | -8            | 149.7         | 146.6   | 29.6    |
| 13   | Transport, storage and repairs    | -1,355                                | 267            | -1,622        | 1,008  | 2,684          | -1,676        | x             | 1,005.2 | 103.3   |
| 14   | – medium-sized and large entities | 595                                   | 2,221          | -1,626        | 1,080  | 2,776          | -1,696        | 181.5         | 125.0   | 104.3   |
| 15   | – small entities                  | -1,950                                | -1,954         | 4             | -72    | -92            | 20            | 3.7           | 4.7     | 500.0   |

Source: calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January – December 2002 and 2003“.

Note: shaded fields contain dynamics of negative values.

### 11.2.5. Profitability indices

In all analyzed aggregates, the profitability indices improved significantly, especially gross and net profitability indices. The largest increase of gross and net profitability – caused by debt cancellation of the coal-mining sector – was registered among medium-sized industrial entities. It caused an increase of indices for the whole industry, the public sector and for the whole economy. In the other sec-

tions, and in the private sector, the increase of these indices was much smaller, because the debt cancellation process did not influence them.

In 2003 the profitability index in construction remained negative, despite an improvement compared to 2002. Other types of activity have shown positive profitability indices.

**Table 55. Profitability indices in the years 2002 and 2003 (%)**

| Item | Description                                 | Sales profitability |      |       | Gross profitability |      |       | Net profitability |      |        |
|------|---|---------------------|------|-------|---------------------|------|-------|-------------------|------|--------|
|      |   | 2002                | 2003 | (4-3) | 2002                | 2003 | (7-6) | 2002              | 2003 | (10-9) |
| 1    | 2   | 3                   | 4    | 5     | 6                   | 7    | 8     | 9                 | 10   | 11     |
| 1    | <b>TOTAL, of this:</b>                      | 3.1                 | 4.2  | 1.1   | 0.7                 | 3.2  | 2.5   | -0.2              | 2.1  | 2.3    |
| 2    | – medium-sized and large entities           | 3.3                 | 4.4  | 1.1   | 0.8                 | 2.8  | 2.0   | -0.2              | 1.7  | 1.9    |
| 3    | – small entities                            | 2.4                 | 2.8  | 0.4   | 0.6                 | 5.1  | 4.5   | -0.1              | 4.3  | 4.4    |
| 4    | <b>Industry</b>                             | 4.1                 | 5.5  | 1.4   | 1.2                 | 4.4  | 3.2   | 0.3               | 3.1  | 2.8    |
| 5    | – medium-sized and large entities           | 4.1                 | 5.6  | 1.5   | 1.2                 | 3.8  | 2.6   | 0.2               | 2.5  | 2.3    |
| 6    | – small entities                            | 4.3                 | 4.1  | -0.2  | 2.3                 | 11.3 | 9.0   | 1.3               | 10.4 | 9.1    |
| 7    | <b>Construction</b>                         | 0.6                 | 1.5  | 0.9   | -1.4                | 0.7  | 2.1   | -2.2              | -0.2 | 2.0    |
| 8    | <b>Commerce and repairs</b>                 | 1.5                 | 1.7  | 0.2   | 0.6                 | 1.2  | 0.6   | 0.1               | 0.6  | 0.5    |
| 9    | <b>Transport, storage and communication</b> | 5.6                 | 8.2  | 2.6   | -1.4                | 3.0  | 4.4   | -3.0              | 1.0  | 4.0    |
|      | <b>Of item 2:</b>                           |                     |      |       |                     |      |       |                   |      |        |
| 10   | private sector                              | 4.0                 | 5.1  | 1.1   | 1.6                 | 3.2  | 1.6   | 0.5               | 2.1  | 1.6    |
| 11   | public sector                               | 0.8                 | 2.3  | 1.5   | -1.7                | 1.5  | 3.2   | -2.5              | 0.3  | 2.8    |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January - December 2002 and 2003“.

### 11.2.6. Financial surplus

Financial surplus is defined as the sum of net profit (profit – not result), and depreciation deductions. The surplus volume proves potential capacities for financing investment with own resources of enterprises. The above discussed significant improvement of financial results had – in some categories – mostly statistical nature. Therefore, in these categories the surplus volume does not prove capacities for financing investment with own resources, as an improvement in the financial results was not accompanied with increased flow of funds to businesses. The above comment does not apply to construction, trade, transport and the private sector.



In 2003, financial surplus rose faster than investment outlays in fixed assets (19.8% and 2.9%, respectively). As a result, the ratio of the surplus to outlays increased. The surplus was bigger than the outlays in fixed assets by 57.4%.

Outlays in fixed assets rose in the whole economy, in industry and in the private sector. In the other presented aggregates, the outlays dropped.

In 2003, incentive to invest was not very high, due to fears of entrepreneurs tied to accession to the European Union, and the political situation in the country. Entrepreneurs put their investment decisions on hold, preferring to invest their money in banks or in other financial instruments. Deposits of enterprises across the country (in PLN and in foreign currencies) rose by PLN 13.2 billion (current deposits from PLN 29.4 to PLN 35.1 billion; and term deposits from PLN 24.4 to PLN 31.9 billion).

**Table 56. Ratio of financial excess to outlays into fixed assets\* (in PLN billion)**

| Item | Description                          | Net profit |      | Depreciation |      | Financial excess |      | Outlays into fixed assets |      | Ratio % |          |
|------|--------------------------------------|------------|------|--------------|------|------------------|------|---------------------------|------|---------|----------|
|      |                                      | 2002       | 2003 | 2002         | 2003 | 2002             | 2003 | 2002                      | 2003 | (7 : 9) | (8 : 10) |
|      |                                      |            |      |              |      |                  |      |                           |      |         |          |
| 1    | 2                                    | 3          | 4    | 5            | 6    | 7                | 8    | 9                         | 10   | 11      | 12       |
| 1    | <b>TOTAL, of this:</b>               | 26.6       | 38.0 | 43.7         | 46.2 | 70.3             | 84.2 | 52.0                      | 53.5 | 135.2   | 157.4    |
| 2    | Industry                             | 15.6       | 24.6 | 26.7         | 28.2 | 42.3             | 52.8 | 29.3                      | 32.5 | 144.4   | 162.5    |
| 3    | Construction                         | 1.0        | 1.1  | 1.0          | 0.9  | 2.0              | 2.0  | 1.0                       | 0.8  | 200.0   | 250.0    |
| 4    | Commerce and repairs                 | 4.1        | 4.6  | 3.7          | 4.1  | 7.8              | 8.7  | 6.3                       | 6.2  | 123.8   | 140.3    |
| 5    | Transport, storage and communication | 3.4        | 4.5  | 9.8          | 10.5 | 13.2             | 15.0 | 9.6                       | 8.4  | 137.5   | 178.6    |
|      | Of item 1:                           |            |      |              |      |                  |      |                           |      |         |          |
| 6    | private sector                       | 23.3       | 30.7 | 28.4         | 30.5 | 51.7             | 61.2 | 37.4                      | 39.8 | 138.2   | 153.8    |
| 7    | public sector                        | 3.3        | 7.3  | 15.3         | 15.7 | 18.6             | 23.0 | 14.6                      | 13.7 | 127.4   | 167.9    |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January – December 2002 and 2003“.

\* Business entities with more than 49 employees.

### 11.2.7. Debt

A high level of debt of business entities remains for years a very serious and so far unsolved economic problem. In recent years, the growth rate of the debt significantly exceeded the growth rate of revenues from overall activity. This reduced the capacity for debt repayment, and led to payment delays and payment

bottlenecks. The structure of debt is dominated by liabilities tied to deliveries and services, taxes, customs duties and insurance. They account for about 40% of total debts. Business entities consider such liabilities the primary form of financing, cheaper than bank credits. Such method of „crediting” causes significant problems in the flow of money to enterprises, and growing liabilities tied to sold goods and services.

In 2003, for the first time in many years, a significant reduction in the dynamics of debt was observed. Debt rose by only 1.7%, much slower than revenues. This situation was largely due to the process of debt reduction in the hard coal mining sector. The cancellation of debts of the coal mining sector reached PLN 18.1 billion (of that total, balance sheet liabilities PLN 13.2 billion). As a result, the debt of the mining and quarrying sector was reduced by half, which in turn served to reduce debt of enterprises and in the public sector. Debt was also reduced in the construction sector. In the other sections, and in the private sector, debt rose, but at a rate much slower than the increase of revenues on overall activity.

Table 57. Debt in the years 2002 and 2003 (in PLN billion)

| Item | Description                              | Total debt |       | of this:  |       |            |       | Dynamics % |         |         |
|------|--|------------|-------|-----------|-------|------------|-------|------------|---------|---------|
|      |  |            |       | Long term |       | short term |       |            |         |         |
|      |  | 2002       | 2003  | 2002      | 2003  | 2002       | 2003  | (4 : 3)    | (6 : 5) | (8 : 7) |
| 1    | 2  | 3          | 4     | 5         | 6     | 7          | 8     | 9          | 10      | 11      |
| 1    | TOTAL, of this:                          | 484.0      | 492.5 | 154.4     | 167.7 | 329.6      | 324.8 | 101.8      | 108.6   | 98.5    |
| 2    | – medium-sized and large entities        | 406.7      | 418.6 | 129.8     | 149.2 | 276.9      | 269.4 | 102.9      | 114.9   | 97.3    |
| 3    | – small entities                         | 77.3       | 73.9  | 24.6      | 18.5  | 52.7       | 55.4  | 95.6       | 75.2    | 105.1   |
| 4    | Industry                                 | 234.9      | 233.2 | 58.2      | 63.1  | 176.7      | 170.1 | 99.3       | 108.4   | 96.3    |
| 5    | – medium-sized and large entities        | 216.7      | 215.1 | 53.8      | 59.7  | 162.9      | 155.4 | 99.3       | 111.0   | 95.4    |
| 6    | – small entities                         | 18.2       | 18.1  | 4.4       | 3.4   | 13.8       | 14.7  | 99.5       | 77.3    | 106.5   |
| 7    | Construction                             | 23.7       | 20.4  | 4.5       | 2.8   | 19.2       | 17.6  | 86.1       | 62.2    | 91.7    |
| 8    | Commerce and repairs                     | 99.5       | 100.7 | 16.5      | 15.7  | 83.0       | 85.0  | 101.2      | 95.2    | 102.4   |
| 9    | Transport, warehousing and communication | 81.5       | 84.9  | 51.2      | 56.5  | 30.3       | 28.4  | 104.2      | 110.4   | 93.7    |
|      | Of item 1:                               |            |       |           |       |            |       |            |         |         |
| 10   | private sector                           | 352.7      | 375.4 | 110.3     | 119.0 | 242.4      | 256.4 | 106.4      | 107.9   | 105.8   |
| 11   | public sector                            | 131.3      | 117.1 | 44.1      | 48.7  | 87.2       | 68.4  | 89.2       | 110.4   | 78.4    |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January - December 2002 and 2003”.

The structure of debt in terms of maturity underwent positive changes, and the share of long-term liabilities rose from 31.9% to 34.1%. It is worth noting that these changes were also caused by the debt reduction of the coal-mining sector, as the cancellation applied to short-term liabilities, which automatically caused an increase of the share of long-term liabilities.

In the public sector, the share of long-term liabilities is much higher than in the private sector, 41.6% and 31.7%, respectively. This results from the fact that this sector dominates the section of power and electricity. Investments in the power and electricity sector are very capital consuming, and the period of their execution is long. They are financed largely with funds obtained from external sources (the share of long-term debts in the whole section of production and supply of electricity, gas and water amounted to 53.3% in 2003).

**Table 58. Components of overall debt\* (in PLN billion)**

| Item | Description                              | Total debt |       | Of this, resulting from: |       |  |      |                   |       |            |       |
|------|--|------------|-------|--------------------------|-------|--|------|-------------------|-------|------------|-------|
|      |  |            |       | deliveries and services  |       | taxes, customs duty and social insurance |      | credits and loans |       | other debt |       |
|      |  | 2002       | 2003  | 2002                     | 2003  | 2002                                     | 2003 | 2002              | 2003  | 2002       | 2003  |
| 1    | 2  | 3          | 4     | 5                        | 6     | 7  | 8    | 9                 | 10    | 11         | 12    |
| 1    | Total                                    | 406.7      | 418.6 | 130.5                    | 139.8 | 40.4                                     | 30.5 | 116.3             | 114.7 | 119.5      | 133.6 |
| 2    | Industry                                 | 216.7      | 215.1 | 68.7                     | 73.5  | 31.5                                     | 20.8 | 70.2              | 70.9  | 46.3       | 49.9  |
| 3    | Construction                             | 16.4       | 15.5  | 9.2                      | 8.5   | 1.6                                      | 1.6  | 3.2               | 2.8   | 2.4        | 2.6   |
| 4    | Commerce and repairs                     | 68.9       | 71.3  | 35.9                     | 40.1  | 1.7                                      | 2.2  | 17.7              | 15.2  | 13.6       | 13.8  |
| 5    | Transport, warehousing and communication | 77.1       | 82.6  | 10.0                     | 10.5  | 4.1                                      | 3.9  | 13.7              | 14.0  | 49.3       | 54.2  |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January – December 2002 and 2003“ and Statistical Bulletins.

\* Business entities with more than 49 employees.

### 11.2.8. Relations tied to debt

Relations tied to debt improved in all analyzed aggregates. The main factors determining this improvement include:

- quick increase of revenues on overall activity,
- significant increase of net profit,
- relatively small growth of debt.

**Table 59. Relations of debt in 2002 and 2003**

| L.p. | Treść                                       | A    |      | B    |      | C    |      | D    |      |
|------|---|------|------|------|------|------|------|------|------|
|      |   | 2002 | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 | 2003 |
| 1    | 2   | 3    | 4    | 5    | 6    | 7    | 8    | 9    | 10   |
| 1    | <b>TOTAL, of this:</b>                      | 41.9 | 38.0 | 5.0  | 4.6  | x    | x    | 103  | 90   |
| 2    | – medium-sized and large entities           | 42.2 | 38.7 | 5.1  | 4.6  | 17.3 | 20.1 | 104  | 90   |
| 3    | – small entities                            | 39.9 | 34.4 | 4.8  | 4.1  | x    | x    | 98   | 93   |
| 4    | <b>Industry</b>                             | 41.9 | 36.9 | 5.0  | 4.4  | 19.3 | 25.9 | 114  | 97   |
| 5    | – medium-sized and large entities           | 41.6 | 36.8 | 5.0  | 4.4  | 19.5 | 24.5 | 113  | 96   |
| 6    | – small entities                            | 45.8 | 38.2 | 5.5  | 4.6  | 17.0 | 41.4 | 125  | 112  |
| 7    | <b>Construction</b>                         | 41.2 | 36.8 | 4.9  | 4.4  | 12.2 | 12.9 | 120  | 114  |
| 8    | <b>Commerce and repairs</b>                 | 26.8 | 23.8 | 3.2  | 2.9  | 11.3 | 12.2 | 80   | 72   |
| 9    | <b>Transport, storage and communication</b> | 91.4 | 86.1 | 11.0 | 10.3 | 17.1 | 18.2 | 122  | 104  |
|      | <b>Of item 1:</b>                           |      |      |      |      |      |      |      |      |
| 10   | private sector                              | 38.6 | 36.5 | 4.6  | 4.4  | 18.4 | 19.9 | 95   | 90   |
| 11   | public sector                               | 54.3 | 43.7 | 6.5  | 5.2  | 14.7 | 20.8 | 130  | 92   |

Source: Calculations by Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of „Financial results of economic units January-December 2002 and 2003”; Central Statistical Office.

A – Relation of debt to revenues from total activity in %

B – Number of months essential for repayment of total debt by average monthly revenues from total activity

C – Relation of the sum of financial surplus (sum of net profit and depreciation) to total debt in %

D – Short-term liabilities discharge cycle in days

**Table 60. Financial flexibility indices in the years 2002–2003**

|   | Item       | Total |       | Of which: |       |              |       |          |       |           |      |
|---|------------|-------|-------|-----------|-------|--------------|-------|----------|-------|-----------|------|
|   |            |       |       | Industry  |       | Construction |       | Services |       | Transport |      |
|   |            | 2002  | 2003  | 2002      | 2003  | 2002         | 2003  | 2002     | 2003  | 2002      | 2003 |
| 1 | 2          | 3     | 4     | 5         | 6     | 7            | 8     | 9        | 10    | 11        | 12   |
| 1 | I degree   | 17.9  | 23.6  | 14.7      | 20.7  | 22.6         | 25.2  | 15.6     | 17.1  | 18.6      | 29   |
| 2 | II degree  | 72.9  | 84.3  | 66.9      | 82.2  | 96.1         | 100.6 | 70.3     | 72.1  | 68.7      | 79.3 |
| 3 | III degree | 104.9 | 117.8 | 100.7     | 118.2 | 125.4        | 127.2 | 110.9    | 114.9 | 79.6      | 89.5 |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of reports of the CSO „Financial results of business entities, January – December 2002 and 2003” and Statistical Bulletins.

Debt cancellation of the coal mining sector resulted in accelerated dynamics of revenues, improvement of financial results and the slow-down of debt dynamics or reduction of the absolute volume of debt in the following aggregates: industry, the public sector and overall economy. In these aggregates, relations tied to debt have recorded a significant improvement.

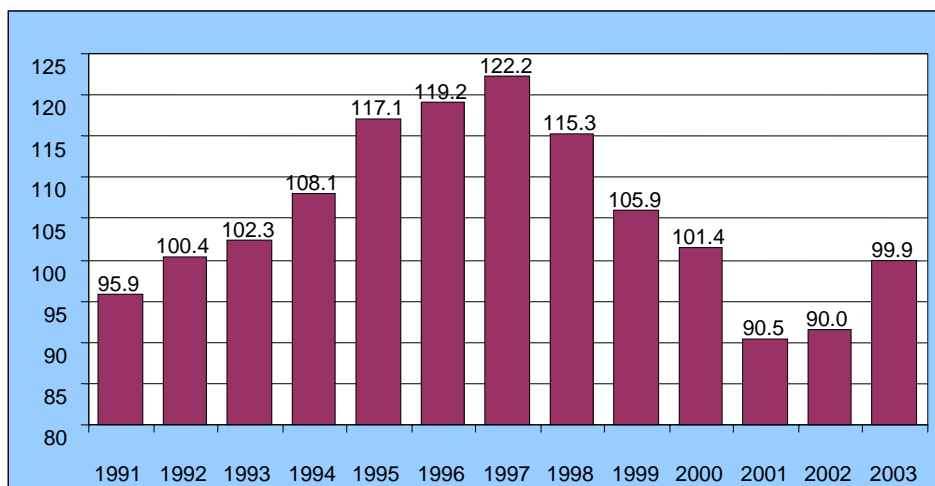
In 2003, financial liquidity of business entities rose. Also in that case the debt cancellation of the mining sector played a huge role.

The 1<sup>st</sup> degree liquidity ratio was on a level higher than the desirable minimum (20%), with the exception of the trade section. The 2<sup>nd</sup> and 3<sup>rd</sup> degree liquidity ratios were higher than the desirable minimum only in the construction sector (100% and 120%, respectively).

### 11.3. Investment outlays

Investments are the condition for the proper development of the economy, and are necessary to improve competitiveness of its individual sections. The scope of investment within an economy provides usually a good reflection of its condition and development perspectives (the cyclical nature of investment must be taken into consideration).

Chart 28. Dynamics of investment outlays (compared to the previous year)



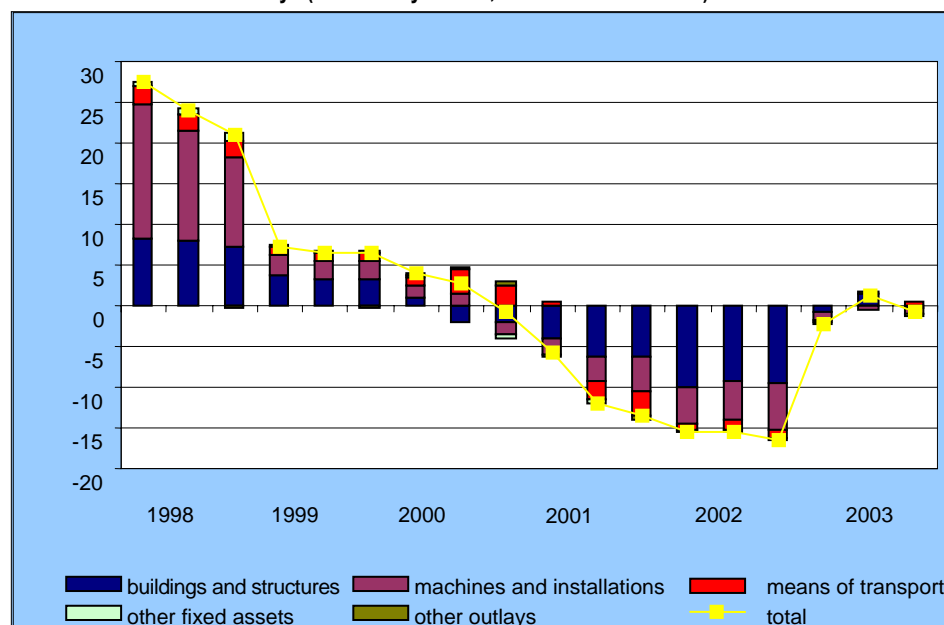
*The data applies to the full group of entities.*

*Source: Statistical Yearbook of the CSO, 2002; Statistical Bulletin, CSO, March 2004; Small Statistical Yearbook 2004.*

The 1990's were characterized by varying economic situation. The first outcome of economic transformation, commenced in mid-80's and 90's, aside from the reduction of inflation and introduction of market economy, was the collapse of

demand and worsening of the financial and economic situation of enterprises. Businesses had limited funds for any development projects. This caused a breakdown in investment activities in 1990–1991. After the period of a recession, business entities increased their investment activity in the subsequent years. Intense investment activities were seen in the enterprise sector in 1995–1997, when the average annual growth of investment reached 19.5%. In 1999, a rapid reduction of investment occurred, due to the decline of outlays in production activity and much weaker dynamics in transport, warehousing and communication. In 2001–2002, investment outlays were falling in all sections of the economy.

**Chart 29. Investment outlays (effective dynamics; data on accrued base)**



Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data of the CSO.

In 2003, a moderate improvement was observed in the area of investment activity. The downward trend was stopped in the first half of 2003. After the three quarters of that year, total investment outlays rose by 1.2%, compared to the same period of the previous year. This trend was not permanent, and in the whole year a decline of outlays by 0.7% was recorded in entities with more than 49 workers. **In the whole group of business entities, the value of effective**

**investment outlays was smaller by only 0.1% from the 2002 result**, which proves a stronger investment activity in smaller entities. The value of investment outlays in the economy in 2003 amounted to PLN 110.4 billion.<sup>49</sup>

The symptoms of revival in investment demand in 2003 were concentrated in the enterprise sector, especially in the area of production activity. High increases of investment outlays in some sections resulted partly from the low investment activity in the previous years (the maximum level of these outlays in overall production activity was seen in 1998). However, in the motor vehicle industry and in the production of radio and television equipment, 2003 was the second subsequent year of very high increase of investment outlays. In the coming years, this should result in an increase of sold output in these sections<sup>50</sup>.

In the other sections of industry, the revival of investment demand was delayed, which could be explained with the still poor economic situation in the global economy; and growth of uncertainty in Poland, tied to the status of public finances and plans for their improvement.

**Table 61. Dynamics of investment outlays in individual sectors of the economy**

| Description                           | 2002                            | 2003     | Dynamics<br>a – current prices<br>b – fixed prices |               |
|---------------------------------------|---------------------------------|----------|--|---------------|
|                                       | PLN million<br>(current prices) |          |  |               |
| Economy, total                        | 56,709.8                        | 56,938.6 | a<br>b   | 100.4<br>99.3 |
| Industry, of this:                    | 29,324.4                        | 32,538.0 | a  | 111.0         |
| – mining and quarrying                | 2,190.0                         | 2,000.2  | a  | 91.3          |
| – manufacturing                       | 18,975.7                        | 22,137.8 | a  | 116.7         |
| – electricity, gas and water supply   | 8,158.7                         | 8,400.0  | a  | 103.0         |
| Construction                          | 997.3                           | 767.3    | a  | 76.9          |
| Commerce and repairs                  | 6,264.9                         | 6,198.3  | a  | 98.9          |
| Transport, storage and communications | 9,633.2                         | 8,437    | a  | 87.6          |

Source: Statistical Yearbook of the Central Statistical Office, March 2003.

In 2003, certain small changes occurred also in the **ownership structure of investment outlays**.

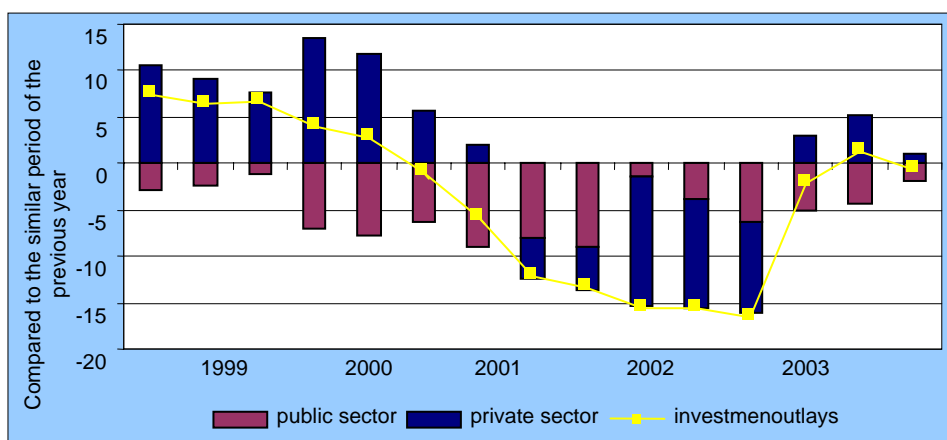
<sup>49</sup> The other data applies to enterprises employing more than 49 workers.

<sup>50</sup> Data for the first quarter of 2004 confirms that indeed.

An increase of the role of the private sector is seen in all areas of activity. It dominates the ownership structure of business entities, and it is also more keen to invest than entities of the public sector<sup>51</sup>, which leads to an increase of the role of private investments in the total outlays. Investment outlays in the public sector show a permanent downward trend, while outlays in the private sector fell in 2001–2002. Improvement in the dynamics of investment outlays in 2003 was caused by the improved situation in the private sector. In 2003, the share of the private sector in investment outlays has shown a durable increase and amounted to 74.0%, which meant an annual increase of 1.6 percentage point in the course of one year. 68% of the value of outlays is attributed to investment purchases.

From the total value of investment outlays, about 43% (39% a year earlier) was performed by entities with foreign capital (with foreign capital exceeding USD 1 million). The value of their investments in effective terms was higher by 10%.

**Chart 30. Investment outlays per ownership sectors (effective changes)**



Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of data of the CSO.

<sup>51</sup> Until 1999, the private sector was characterized with much faster growth of investment than the public sector. In 2000, growth was registered in the private sector while outlays in the public sector dropped. In 2001 and 2002, both the sectors saw a reduction of investment, and the decline in the private sector was lower (in 2001, 11.6% and in 2002, by 13.2%, while the decline in the public sector reached 31% and 30.6% in the respective years).



In 2003, about 70 thousand investment projects were commenced (increase by 56.2%), of which about half – similarly as in 2002 – constituted electric and gas service lines, whose unit cost estimate value is low. The total estimated value of commenced projects reached PLN 26.3 billion, and was higher by 35.2% compared to the results of 2002.

The factors which exerted positive influence on the level of investment outlays include:

- improvement of the financial situation of enterprises, which coupled with the large share of own resources in investment outlays should increase the level of outlays,
- opening up of the European market to trade, as a result of removing the last barriers,
- stimulation of infrastructure investment as a result of projects executed with the funds of the European Union,
- acceleration of privatization processes which, in a situation where the private sector accounts for investment growth in the recent years, has a positive influence on investment processes,
- actions of the monetary authorities, targeted at maintaining low rate of prices growth, influencing the level of effective interest rates, which are one of the conditions determining investment outlays in enterprises using external sources of financing for their investment,
- the perspective of introducing the common European currency, which forces actions meant to reduce the public finance deficit – the main rival of firms which try to acquire capital in the financial markets.

## **11.4. Foreign direct investment in Poland**

### **11.4.1. The volume of foreign direct investments in 2003**

On the basis of data of the National Bank of Poland<sup>52</sup>, the value of foreign investment in 2003 reached USD 4.2 billion.

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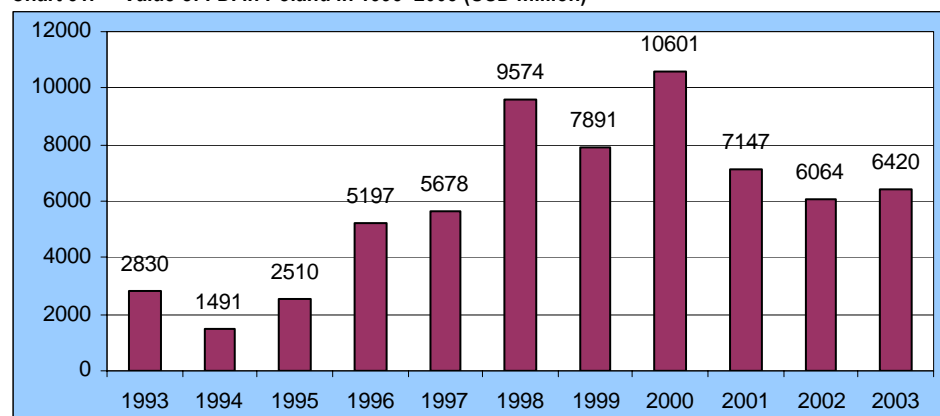
<sup>52</sup> Data from the Payments Balance of the NBP, on the basis of transactions.

**Table 62. Influx of FDI according to NBP**

| YEAR | 1Q    | 2Q    | 1 <sup>st</sup> half of the year | 3Q    | 1Q–3Q | 4Q    | TOTAL |
|------|-------|-------|----------------------------------|-------|-------|-------|-------|
| 2000 | 1,964 | 1,279 | 3,243                            | 1,030 | 4,273 | 5,067 | 9,340 |
| 2001 | 1,421 | 293   | 1 714                            | 903   | 2,017 | 3,096 | 5,713 |
| 2002 | 1,099 | 819   | 1 918                            | 847   | 2,765 | 1,366 | 4,131 |
| 2003 | 1,425 | 891   | 2 316                            | 728   | 3,044 | 1,181 | 4,225 |

Source: National Bank of Poland, Payments Balance on the basis of transactions.

According to the data published by the Polish Information and Foreign Investment Agency (PAIIZ), Poland received USD 6.42 billion<sup>53</sup>. This is USD 356 million more, compared to 2002, which means that the downward trend in the inflow of FDI to Poland was stopped.

**Chart 31. Value of FDI in Poland in 1993–2003 (USD million)**

Source: PAIIZ.

The cumulative value of foreign investment in Poland as of the end of 2003 amounted to USD 72.7 billion. Of this, large investment projects, which value ex-

<sup>53</sup> The data of NBP and PAIIZ differs from the standpoint of methodology. NBP provides the status of foreign obligations tied to direct investment in its statement of foreign liabilities, on the basis of reports of business entities. The PAIIZ collects data using questionnaires: it sends questions on FDI to individual foreign investors, focusing on large investment projects (over USD 1 million). The received answers are used to determine the volume of FDI. Sometimes not all investment projects, registered by PAIIZ, are realized in a given year and in the declared amount. As a result, the data from PAIIZ is of estimate nature, and is higher than data of the NBP or the CSO. However, it is believed that the data of PAIIZ properly reflects the dynamics of the influx of foreign direct investment into Poland – especially for the last five years of economic transformation in Poland.

ceeded USD 1 million, amounted to USD 69.44 billion. Investments of less than USD 1 million have been estimated by the PAIIZ at USD 3.84 billion. Among the foreign investment projects executed in 2003, 51% were *greenfield* projects. They are particularly important for the economy, because they contribute to the inflow of new investments and modernization of industry; and create new jobs – both in the newly opened enterprises and in their environment.

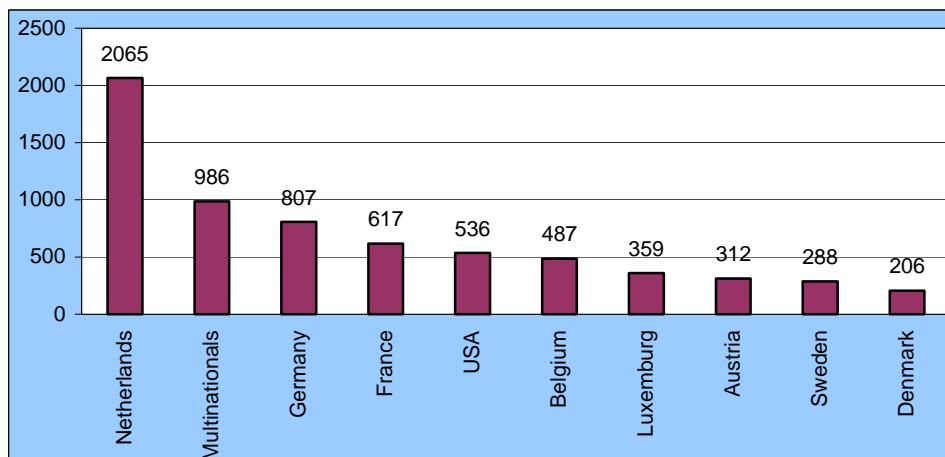
#### **11.4.2. Countries of origin of foreign direct investment**

In 2003, the main stream of investment came from Europe and the USA. The largest volume of FDI influx came from countries of the EU-15. Their total value amounted to USD 5.1 billion, which corresponded to about 80% of the total volume of FDI influx to Poland in 2003. At the same time, companies from certain countries reduce their capital involvement in Poland, which results from the fact of selling their shares in enterprises to other investors. In 2003 this applied to firms from South Korea, Spain, Japan and Canada.

The list of largest investor countries, from the standpoint of the cumulative value of FDI coming into Poland, did not undergo any major changes, compared to the status at the end of 2002. Investors from France still occupy the first place. The total value of their investments amounts to USD 13.9 billion. The largest sums were invested by the French in the telecommunications sector (France Telecom and Vivendi) – USD 5.3 billion; and in commerce and repairs (Casino, Carrefour, Auchan) – total of USD 2.3 billion. These two areas of operations account for USD 54.5 of the cumulative value of French investment in Poland.

The second place belongs to companies from the Netherlands. The largest investor is the multi-media holding United Pan-Europe Communications which invested USD 1.2 billion in Poland; and ING Group, whose value of invested capital amounts to USD 990.0 million.

The third largest group are companies from the USA. The largest US-based investors include Citibank (USD 1.3 billion) and General Motors Corporation (USD 1.01 billion), maker of Opel vehicles. American companies have declared further investments, for a total of USD 2.9 billion. The purchase of the F-16 multi-purpose fighter aircraft will certainly influence an increase of FDI coming from the USA.

**Chart 32. FDI in 2003, according to countries of origin of capital (USD million)**

Source: PAIIZ.

**Table 63. Cumulative value of FDI in Poland per country of capital origin (cumulative FDI at the end of 2003, USD million)**

| No. | Place on the list in 2002 | Country of origin of capital | Cumulative value of invested capital as at: |            |           | Investment plans |
|-----|---------------------------|------------------------------|---|------------|-----------|------------------|
|     |                           |                              | 31.12.2002                                  | 31.12.2003 | Share (%) |                  |
| 1.  | 1                         | France                       | 12,172.1                                    | 13,857.2   | 20.0      | 1,733.1          |
| 2.  | 4                         | The Netherlands              | 5,846.1                                     | 9,863.2    | 14.2      | 1,262.5          |
| 3.  | 2                         | USA                          | 8,736.1                                     | 8,689.3    | 12.5      | 2,898.4          |
| 4.  | 3                         | Germany                      | 7,841.0                                     | 8,414.7    | 12.1      | 1,372.7          |
| 5.  | 6                         | Italy                        | 3,696.2                                     | 3,837.4    | 5.5       | 1,113.0          |
| 6.  | 5                         | Great Britain                | 4,051.8                                     | 3,689.8    | 5.3       | 279.7            |
| 7.  | 8                         | Multinational                | 2,424.7                                     | 3,161.6    | 4.6       | 237.0            |
| 8.  | 7                         | Sweden                       | 2,788.8                                     | 3,062.3    | 4.4       | 259.8            |
| 9.  | 10                        | Belgium                      | 1,645.3                                     | 2,111.4    | 3.0       | 460.8            |
| 10. | 9                         | Denmark                      | 1,839.2                                     | 2,048.1    | 3.0       | 349.8            |
| 11. | 12                        | Russia                       | 1,323.2                                     | 1,291.9    | 1.9       | 50.0             |
| 12. | 16                        | Austria                      | 795.3                                       | 1,122.9    | 1.6       | 221.9            |
| 13. | 14                        | Cyprus                       | 998.9                                       | 1,106.1    | 1.6       | 180.0            |
| 14. | 13                        | Ireland                      | 1,059.7                                     | 1,087.7    | 1.6       | 69.7             |
| 15. | 15                        | Switzerland                  | 925.0                                       | 1,087.3    | 1.6       | 168.9            |
| 16. | 11                        | South Korea                  | 1,465.3                                     | 965.8      | 1.4       | no data          |
| 17. | 19                        | Greece                       | 558.0                                       | 556.5      | 0.8       | no data          |
| 18. | 25                        | Luxembourg                   | 143.3                                       | 541.4      | 0.8       | 134.0            |
| 19. | 20                        | Finland                      | 405.6                                       | 479.2      | 0.7       | 179.0            |

| No.                               | Place on the list in 2002 | Country of origin of capital | Cumulative value of invested capital as at: |            |           | Investment plans |
|-----------------------------------|---------------------------|------------------------------|---|------------|-----------|------------------|
|                                   |                           |                              | 31.12.2002                                  | 31.12.2003 | Share (%) |                  |
| 20.                               | 18                        | Portugal                     | 560.2                                       | 423.4      | 0.6       | 66.6             |
| 21.                               | 17                        | Spain                        | 592.2                                       | 387.4      | 0.6       | 40.5             |
| 22.                               | 23                        | Norway                       | 304.3                                       | 343.7      | 0.5       | 69.8             |
| 23.                               | 21                        | Japan                        | 351.8                                       | 258.0      | 0.4       | 262.4            |
| 24.                               | 22                        | Canada                       | 314.0                                       | 212.7      | 0.3       | 287.9            |
| 25.                               | 24                        | Croatia                      | 173.0                                       | 173.0      | 0.3       | 16.0             |
| 26.                               | 31                        | Australia                    | 143.3                                       | 158.1      | 0.2       | 11.0             |
| 27.                               | 26                        | Turkey                       | 100.1                                       | 100.1      | 0.1       | 58.0             |
| Total countries from item 1 to 27 |                           |                              | 52 821.3                                    | 69 030.2   | 99.4      | 11,782.5         |
| Remaining 9 countries             |                           |                              | 330.9                                       | 410.8      | 0.6       | 275.8            |
| Investments above USD 1 million   |                           |                              | 53 152.2                                    | 69 441.0   | 100.0     | 12,058.3         |
| Estimated FDI below USD 1 million |                           |                              | 3,681.3                                     | 3,265.0    |           |                  |
| TOTAL                             |                           |                              | 56,833.5                                    | 72,706.0   |           |                  |

Source: PAIIZ.

Investors from 35 countries are present in Poland; and the number of companies which invested more than USD 1.0 million reached 996 in 2003. This was 17 firms more than in 2002. The total number of investors from countries of the EU-15 reached 756, which constituted 75% of the total number of foreign investors in Poland.

#### 11.4.3. Sector structure of FDI

In 2003, the largest volume of funds was invested in **production activity**. The value of FDI influx reached about USD 3.0 billion, which constitutes 46.0% of their total value. In 2002 the volume reached the level of USD 2.1 billion and 34.3%. The largest volume of funds was invested in the production of chemicals, products made of other non-metal raw materials, electric and optical equipment.

The second largest area of foreign investments were financial services, where foreign companies injected USD 2.4 billion, which constituted 37.8% of the total value of FDI in 2003.

Taking into account the total cumulative value of investment, foreign companies invested the most in the **production activity sector** (40.0%). The largest volume of funds in that sector was invested in the production of means of transport – USD 6.6 billion. Production of transport means in Poland is dominated by

foreign capital. In the motor vehicle sector, the largest investors are well-known international holdings: Fiat, General Motors, Isuzu, Volkswagen, Toyota, Volvo.

**Table 64. Value of foreign direct investment in Poland, divided into sectors according to the Polish Classification of Activity (status at 31.12.2003, USD millions)**

| Sections of PKD                             | Capital invested in 2003 | Cumulative FDI at the end of 2003 | Share (%) | Investment plans |
|---|--------------------------|-----------------------------------|-----------|------------------|
| Manufacturing, of that:                     | 2,964.9                  | 27,776.9                          | 40.0      | 4,826.5          |
| – transport equipment                       | 312.3                    | 6,581.3                           | 9.5       | 775.0            |
| – food articles, beverages, tobacco         | 314.8                    | 6,247.0                           | 9.0       | 377.8            |
| – other non-metal goods                     | 533.0                    | 3,936.1                           | 5.7       | 567.5            |
| – chemicals and chemical products           | 570.0                    | 2,503.1                           | 3.6       | 706.5            |
| – electrical and optical equipment          | 388.7                    | 2,090.6                           | 3.0       | 274.7            |
| – paper production, publishing and printing | 232.7                    | 1,960.2                           | 2.8       | 397.5            |
| – wood and wooden products                  | 162.2                    | 1,494.8                           | 2.2       | 195.0            |
| – rubber and plastic products               | 288.2                    | 968.8                             | 1.4       | 454.2            |
| – metals and processed metal goods          | 264.5                    | 770.5                             | 1.1       | 757.7            |
| – production of machines and equipment      | 166.8                    | 709.4                             | 1.0       | 122.2            |
| – fabrics and textile products              | -58.6                    | 247.3                             | 0.4       | 177.1            |
| – production not classified elsewhere       | -226.5                   | 236.9                             | 0.3       | 20.1             |
| – leathers and leather goods                | 16.8                     | 31.4                              | 0.0       | 1.5              |
| Financial services                          | 2,426.5                  | 16,190.5                          | 23.3      | 1,382.5          |
| Wholesale and retail commerce, repairs      | 298.3                    | 8,127.4                           | 11.7      | 905.1            |
| Transport, storage and communications       | 159.5                    | 7,089.1                           | 10.2      | 249.7            |
| Construction                                | -270.0                   | 2,938.7                           | 4.2       | 325.1            |
| Electricity, gas and water supply           | 314.7                    | 2,565.7                           | 3.7       | 1,223            |
| Services: municipal and individual          | 337.1                    | 2,060.8                           | 3.0       | 697.2            |
| Real estate services                        | 141.6                    | 1,570.5                           | 2.3       | 2,019.9          |
| Hotels and restaurants                      | 36.6                     | 847.2                             | 1.2       | 392.2            |
| Mining and quarrying                        | 6.0                      | 224.5                             | 0.3       | 13.0             |
| Agriculture                                 | 4.8                      | 49.6                              | 0.1       | 24.1             |
| Total investments exceeding USD 1 million   | 6,420.1                  | 69,441.0                          | 100.0     | 12,058.3         |
| Estimated investments below USD 1 million   | x                        | 3,265.0                           |           | x                |
| TOTAL                                       | x                        | 72,706.0                          |           | x                |

Source: PAIIZ.

The second largest sector in terms of the volume of invested capital is the production of food products, drinks and tobacco. The largest investors are: Philip Morris, Coca-Cola Hellenic Bottling Company and Imperial Tobacco Plc. Each of them invested more than USD 0.5 billion. The next large area of production activ-

ity is the manufacture of goods made of other non-metal raw materials. The largest investors in this sector are French companies Saint-Gobain and Lafarge. Each of them invested USD 690.0 million.

Financial services are another section where the value of FDI is very high. The largest investors in this area include: European Bank for Reconstruction and Development, Hypo und Vereinsbank (Germany, main shareholder of Bank Przemysłowo-Handlowy PBK S.A.), Citigroup (USA, principal shareholder of Bank Handlowy) and KBC Bank from Belgium, the main shareholder of Kredyt Bank and Warta insurance company. The total value of the investments made in Poland by the above financial institutions amounts to USD 6,621 million.

The third largest area of foreign investments is the commerce and repairs section, where the largest investors are: Metro AG (Germany), Tesco Plc (Great Britain), Carrefour (France), Casino (France). Those 4 companies invested a total of USD 3,621.7 million, which constitutes 44.5% of total value of FDI in that section.

The cumulative value of foreign direct investments in these three sectors listed above – production activity, financial services, commerce and repairs – amounted to USD 52.1 billion. This is 75.0% of the total value of FDI in Poland.

#### 11.4.4. The largest individual investors in 2003

Table 65. The largest individual foreign investors in 2003, USD million

| No. | Investor  | Invested capital | Country of registered seat | Remarks  |
|-----|---|------------------|----------------------------|--|
| 1.  | Fiat-GM Powertrain N.V  | 432.2            | The Netherlands            | Fiat-GM Powertrain is an Italia-American company, which started the production of a modern Diesel engine, with 1.3 liter capacity.   |
| 2.  | GE Capital Real Estate/Heitman Central Europe Property Partners | 254.7            | Multinational              | The international company GE Capital Real Estate/Heitman Central Europe Property Partners invests in the Polish real estate market. It is a new investor in Poland.                |
| 3.  | EUROPOLIS INVEST  | 237.3            | Austria                    | Europolis Invest is a developer and trader of real estate. Its shareholders are: Investkredit Bank AG - 65% and the European Bank for Reconstruction and Development (EBRD) – 35%. |
| 4.  | General Motors Corporation                                      | 210.0            | USA                        | Production of Opel vehicles. GMC is the world's largest motor vehicle producer.  |
| 5.  | Deutsche Bank AG  | 183.3            | Germany                    | Deutsche Bank AG invests in the banking sector and in real estate  |

| No. | Investor           | Invested capital | Country of registered seat | Remarks  |
|-----|--------------------|------------------|----------------------------|--|
| 6.  | ITI Media Group NV | 160.0            | the Netherlands            | Media and entertainment. Owns the Multikino network of movie theatres. Has shares in TV stations TVN, TVN 7, TVN 24, TVN Meteo, in the production company ITI Film Studio and Internet portal onet.pl  |
| 7.  | Electrabel S.A.    | 145.4            | Belgium                    | Electrabel S.A. is a Belgian company, which produces and distributes electricity. In 2003, the company purchased 60% of shares in the T. Kościuszko Power Plant in Polaniec.   |
| 8.  | Lafarge            | 140.0            | France                     | Holds shares in the Kujawy Cement and Lime Works, and in the Wierzbica and Małogoszcz cement plants. It owns also the following companies: Lafarge Cement Polska S.A., Lafarge Gips Polska S.A., BRAAS Polska sp. z o.o.   |
| 9.  | KBC Bank N.V.      | 135.5            | Belgium                    | Banking. Principal shareholder of Kredyt Bank and Warta insurance company.   |
| 10. | Vattenfall AB      | 110.0            | Sweden                     | Vattenfall AB is one of the largest European producers of electricity. It is a shareholder in the combined heating and power plants Elektrociepłownie Warszawskie S.A., where it holds 45% of shares; and controls 53.51% of shares in the Upper Silesian Power Company (Górnśląski Zakład Elektroenergetyczny). |

Source: PAIIZ.

Those 10 companies invested a total of USD 2,008.5 million – which constitutes 31.3% of total influx of FDI to Poland in 2003.

#### 11.4.5. The largest investors from the standpoint of cumulative investment value

The list of the largest investors in terms of cumulative value of investment did not change significantly. The largest investor in Poland is still France Telecom, the principal shareholder of Telekomunikacja Polska S.A.

10 companies invested a total of USD 26,503.8 million, which constitutes 38.2% of the total value of large investment projects – above USD 1 million.

**Table 66. The largest individual foreign investors in 2002, according to cumulative value of investment, who invested more than USD 1.0 million**

| No. | Investor  | Invested capital | Country of registered seat | NOTES   |
|-----|---|------------------|----------------------------|---|
| 1.  | France Telecom  | 4 020.3          | France                     | Holds: 33.9% shares in TP S.A. and 34.0% in PTK Centertel Sp. z o.o.  |
| 2.  | European Bank for Reconstruction and Development (EBRD) | 2 695.0          | Multinational              | Invests in various projects. Holds shares, among others, in the following firms: BPH PBK S.A., Dalkia Termika, Fiat/FSM, Kredyt Bank, Kruszwica S.A., Lafarge Polska, PKP, PEKAO S.A., Polska Telefonia Cyfrowa Sp. z o. o. |



| No. | Investor                              | Invested capital | Country of registered seat | NOTES  |
|-----|---------------------------------------|------------------|----------------------------|--|
| 3.  | FIAT                                  | 1 768.7          | Italy                      | Fiat Auto Poland S.A. The company owns also the following subsidiaries: Fiat Finance Polska S.A. Fiat Ubezpieczenia Majątkowe S.A., Fiat Ubezpieczenia Życiowe S.A., Fiat Bank Polska S.A.   |
| 4.  | Hypo und Vereinsbank                  | 1 336.0          | Germany                    | Holds shares in the following firms: Bank Przemysłowo-Handlowy PBK S.A., National Investment Fund Hetman S.A., CAIB Securities S.A. CAIB Financial Advisers Sp. z o. o. CAIB Investment Management S.A. CAIB TFI S.A., CAIB Fund Management S.A. |
| 5.  | Citigroup                             | 1 300.0          | USA                        | Citibank Bank Handlowy w Warszawie S.A.  |
| 6.  | KBC Bank N.V.                         | 1 290.0          | Belgium                    | KBC Representative Office Polska, 66.5% of shares in Kredyt Bank S.A., 70.11% shares in insurance company TU Agropolisa S.A., 75.13% of shares in insurance company TU Warta S.A.  |
| 7.  | OAQ Gazprom                           | 1 283.8          | Russia                     | Holds 48.0% in Europol Gaz S.A. and in Polgaz Telekom S.A.   |
| 8.  | Vivendi Universal                     | 1 243.4          | France                     | Controls 49.0% shares in Elektrim Telekomunikacja S.A., 50.0% of shares in Carcom S.A. and 10.0% in Elektrim S.A.  |
| 9.  | United Pan-Europe Communications N.V. | 1 200.0          | the Netherlands            | UPC offers cable TV, Internet access and telephones in 18 European countries and in Izrael. In Poland it has the company UPC Polska, 25% of shares in UPC Telewizja Kablowa cable television firm and 25% in Canal + Cyfrowy.                    |
| 10. | Uni Credito Italiano                  | 1 200.0          | Italy                      | Controls 53.2% shares in Bank Pekao SA. UCI is the largest Italian bank.   |

Source: PAIiZ.

## 11.5. Entrepreneurship

### 11.5.1. Barriers to enterprise development

Identification of barriers to enterprise development is extremely important, as they have a negative influence on the economy. Responses of business people, provided in questionnaires, can also be a useful source of information on the existing institutional barriers, which hinder enterprise development. A certain limitation of the methodology for applying questionnaires in this context is a natural tendency – present among all social groups, including business people – to seek the reason for own problems more in external than internal factors. Thus, it is natural that the entrepreneurs would less frequently declare that the problems of their firms are tied to poor competitive skills or not matching the product to market requirements. They are more willing to see the barriers in such issues as

excessive taxes. Despite that, a careful analysis of areas, which the business people point out as particularly disturbing for their activity, can be a source of valuable recommendations for economic policy, oriented on the support and promotion of entrepreneurship.

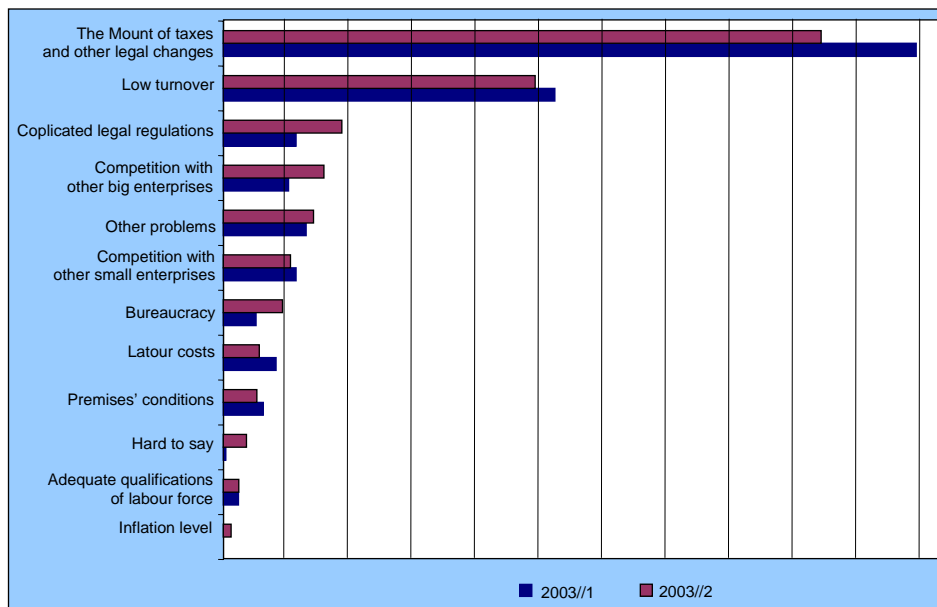
**Questionnaire research conducted by the Polish Confederation of Private Employers (PKPP)** shows that the most significant problems, reported by small and medium-sized enterprises, are the **level of taxes and costs of labour**. The second significant problem for business activity is **the inflexible labour law and burdensome administrative procedures**. The level of interest rates and foreign exchange rates are less problematic, compared to 2002. However, the entrepreneurs more frequently complain about bad infrastructure and activities of the banks. According to the questionnaires, the largest portion – 20% of time dedicated to running the business is spent by small and medium-sized entrepreneurs in various offices. This is twice more than the time dedicated to analyzing changes in the environment, and three times more than time spent in sector meetings and scientific conferences. The formalities tied to the various public and legal charges are also a serious hindrance, as well as the time needed to fulfill them – especially in the case of small firms, which still use the traditional form of making payments and complying with administrative duties, i.e. visits at the various offices. Entrepreneurs criticize both the improper procedures and bad service. The entrepreneurs are also very skeptical about the effectiveness of the judicial system.

In view of the research conducted by the PKPP, the following three barriers are named as most important:

- **instability of legal regulations,**
- **the amounts of taxes and other legal charges, and**
- **complicated legal regulations.**

The next two frequently named factors are **bureaucracy and high labour costs** (the evaluation of both categories exceeded 5 points).

Some time ago, research used to show that the main barrier limiting development of firms was lack of capital. Currently this factor is still reported as important, but much less so than obstacles of administrative and bureaucratic nature.

**Chart 33. The most important problems faced by entrepreneurs**

Source: Questionnaire research of the Ministry of Economy and Labour.

In a research conducted by the Ministry of Economy and Labour, entrepreneurs most frequently reported **small volume of turnover** as the barrier to their activity. They also listed **competition with large enterprises**. The higher importance of the latter factor can be due to the fact that small-sized firms are more sensitive to bad economic situation. They can feel more competitive pressure from the larger ones, which fared better during the period of bad economic situation. Certain entrepreneurs named also inflation level as the most important problem faced by their firm – a factor not mentioned in the previous questionnaire. Regardless of the size of business, the level of taxes and charges is listed as the main problem in business activity. The second most frequently listed problem is different in the various types of enterprises. In the case of the smallest enterprises, the problem is small turnover volume; small ones complain of complicated legal regulations; while medium-sized ones have problems with competition from their larger rivals. It can be stated that the improvement in the situation of firms in the past year led to improvement in terms of receivables. The business people complain less frequently of payment bottlenecks (5<sup>th</sup> largest problem in the research of PKPP, 1<sup>st</sup> during the previous edition). In sum, most entrepre-

neurs stated that the main problem for their activity are their relations with public administration bodies (sum of responses for: „level of taxes and charges”, „complicated regulations” and „bureaucracy” – 53% of respondents in the research of Ministry of Economy, Labour and Social Policy).

Regardless of the opinion on the perspectives for development of their business, entrepreneurs list the following reasons influencing the development of small enterprises: change of the economic situation of the country (55% of responses) and change in sales opportunities (12%).

The statements on administrative barriers and excessive formality of procedures result primarily from the fact, that entrepreneurs do not perceive these issues as having direct influence on their activity; and the time they spend to comply with all requirements could be used for acquiring new customers and for the operations of the company. However, quite often these barriers can be cited as another justification for the internal problems of the business. Entrepreneurs would less frequently declare that the problems of their firms are tied to the small scope of business, poor competitive skills or not matching the product to market requirements. They admit very rarely to losing in competition with other entities (this is cited more frequently by small entrepreneurs – GW Infor). In this context, accession to the EU was also sometimes named as a barrier.

**Difficult access to capital** is one of the most serious development barriers, especially for small and medium-sized enterprises. Quite often, banks perceive investments of the SMEs sector as risky and difficult to service, taking into account the relatively high cost of customer verification and monitoring compared to the generated profits. Entrepreneurs give up the idea of contracting credits both due to the burdensome banking procedures, and due to the excessively high level of debt and lack of appropriate collateral (PKPP).

In many questionnaires, **issues tied to labour relations** are cited as the area, which still poses many problems for entrepreneurs. The business people prefer more flexible forms of employment, and try to adapt the Labour Code accordingly. They propose that rules should be differentiated, depending on the size of businesses. Requirements regarding employment of workers similar for small firms and for large, stable ones results in the large scope of the gray zone of the economy, claim entrepreneurs. Entrepreneurs decided that from the reforms of the labour law, introduced so far, the largest influence on their

business was exerted by changes in the rules regarding remuneration for the period of illness, for overtime work and for holidays; as well as changes regarding termination of labour contracts and amounts of severance payments, as well as regulations concerning limitations of the reasons to dissolve work relations. Desired changes, that would have a positive influence on business, include liberalization of rules on weekly work time norms, labour safety and hygiene regulations, and the rules, which limit the possibility for laying employers off (PKPP).

Table 67. Barriers to enterprise development<sup>54</sup>

|            | changes of taxes,<br>bad regulations | accession to the EU | fluctuations in foreign<br>exchange rates | low demand | collection of receiv-<br>ables, payment<br>hold-ups | price increases | sharp competition | bad financial situation<br>of buyers | uncertainty regarding<br>political situation | problems with<br>obtaining credit | lack of liquidity |
|------------|--------------------------------------|---------------------|---|------------|---|-----------------|-------------------|--------------------------------------|--|-----------------------------------|-------------------|
| 1Q of 2002 |                                      |                     | 17.4                                      | 22.2       | 16.7  | 5.3             | 8.5               | 19.5                                 |  | 3.7                               | 9.2               |
| 2Q of 2002 |                                      |                     | 17.9                                      | 25.3       | 20.1  | 4.2             | 13.2              | 21.7                                 |  | 4.9                               | 6.7               |
| 3Q of 2002 |                                      |                     | 16.4                                      | 22.6       | 16.8  | 4.0             | 10.7              | 15.1                                 |  | 5.5                               | 8.0               |
| 4Q of 2002 |                                      |                     | 13.9                                      | 19.9       | 17.6  | 2.7             | 8.5               | 16.6                                 |  | 7.2                               | 7.5               |
| 1Q of 2003 |                                      |                     | 14.3                                      | 19.7       | 17.1  |                 | 6.4               | 16.5                                 |  | 9.0                               | 7.5               |
| 2Q of 2003 | 2.0                                  |                     | 15.5                                      | 20.4       | 17.4  | 5.3             | 8.2               | 17.1                                 |  | 9.2                               | 9.5               |
| 3Q of 2003 | no data                              | no data             | no data                                   | no data    | no data   | no data         | no data           | no data                              |  | no data                           | no data           |
| 4Q of 2003 | 10.9                                 | 3.7                 | 13.5                                      | 15.6       | 14.5  | 3.6             | 8.3               | 9.8                                  |  | 8                                 | 6.3               |
| 1Q of 2004 | 11.2                                 | 7                   | 14.4                                      | 12.8       | 13.3  | 5.8             | 8.4               | 6.6                                  |  | 6.3                               | 5.3               |
| 2Q of 2004 | 17.2                                 | 14.2                | 13.8                                      | 11.4       | 9.8   | 8.3             | 8.1               | 6.3                                  | 6.1  | 5.2                               | 4.8               |

Source: NBP.

**Export** is very important to achieve and maintain high level of competitiveness. It is an important area of activity for most businesses. Entrepreneurs cite two groups of problems in undertaking export activity: problems with obtaining market information and information on potential contractors and their credibility. This problem is much more pronounced in the case of small firms. For them, the

<sup>54</sup> The development barriers factors were calculated on the basis of proportion of enterprises which reported the existence of a given type of problem to the total number of enterprises participating in the questionnaire (including those firms which did not provide any answers on development barriers).

cost of obtaining information is relatively higher, which results from their smaller resources, both in terms of capital and human resources. Here business people complain also of much smaller support from government agencies, compared to firms from other countries. It is worth to notice that business people rarely list differing legal regulations, competition from other entities, lack of financing or the need to comply with high quality expectations as the barriers to export activity. This, however, can be due to the lack of full information regarding operations in the foreign markets than from the absence of other difficulties.

#### **11.5.2. Instruments for enterprise support**

Execution of another programme addressed to small and medium-sized enterprises was commenced in 2003. On 4th February 2004, the Council of Ministers adopted the document „**Government policy guidelines for small and medium-sized enterprises for 2003–2006**”. This is a continuation and development of the current policy towards small and medium-sized enterprises.

The government decided that the activities supporting small and medium-sized enterprises will be targeted at stimulating the economic activity of these firms, which guarantees increase of employment, increase of their competitiveness and the ability to function in the European Common Market. The policy would be implemented with various legal, organizational, financial, information and training instruments in the following areas:

- support of undertakings which further the development of enterprises,
- improvement of the legal and administrative environment of SMEs,
- development of the institutional environment of SMEs,
- support for the integration of firms and their international activity.

The tasks defined in the said document were executed through the Polish Agency for Enterprise Development (PAED), the network of the National SMEs Services Network (KSU) which is supervised by the Agency, as well as through the system of Regional Financing Institutions, which cooperate with the Agency.

The support of projects which promote the development of enterprises is the most important, from the perspective of entrepreneurs, area of the „Government policy guidelines..”

Actions executed in this respect in 2003 include:

- facilitating entrepreneurs access to knowledge on the management and development of business,
- facilitating entrepreneurs access to specific advisory assistance,
- financial support for entrepreneurs in their attempts for adaptation, diversification and geared at the development of new areas of activity.

The small and medium-sized entrepreneurs can profit from free information and advisory services, financed with the state budget resources and offered at the Consulting and Advisory Centres. In 2003 these services were used by 51 thousand of entrepreneurs and persons commencing business activity. This was almost twice as much as in 2002.

Aside from the support designed directly for small and medium-sized enterprises, in 2003 actions were also undertaken aimed at improvement of the legal and administrative environment for business, as well as actions tied to the development of entrepreneurial attitudes.

The most important activity in that area, undertaken in 2003, was the development of a draft law on freedom of business activity along with the secondary legislation. Most of these regulations came into force in 2004. They reduce the number of activities for which permits or licenses are required and introduce the obligation for free of charge provision of binding interpretations of tax regulations by the tax authorities in individual cases. They also introduce the rule that – as of 1 January 2007 – the municipality will be a “one stop shop” for individuals declaring their wish to commence business activity, where they will be able to register for statistical, tax and social insurance purposes.

The Council of Ministers proposed also a package of activities to stimulate entrepreneurship under the „Plan of growth fostering activities in 2003–2004 – Enterprise – Development – Work II”.

In 2003, actions were undertaken also to improve the institutional environment in which businesses operate. The most important ones include:

- development of a network of institutions supporting entrepreneurs, such as the National SME Services Network, Euro Info Centres,
- development of a system of loan and guarantee funds for small and medium-sized enterprises,
- establishment and development of databases on the Internet.

In 2003, there were 178 centres of the National SME Services Network, and 32 of that total number were new centres. The network of Consulting and Advisory Centres grew from 130 to 158 centres. The Euro Info network gained 2 more centres, and functions currently in 14 provinces.

Development of a system of loan and loan guarantee funds for small and medium-sized enterprises was continued as execution of the document „**Capital for Enterprise**” (adopted by the Council of Ministers in August 2002). In 2003, 39 loan funds received capital support amounting to PLN 45 million and the Bank Gospodarstwa Krajowego took up shares in 6 funds, for a total of PLN 10 million.

Aside from the financial support for activities of entrepreneurs, improvement of the legal and administrative environment for business and development of the institutional environment, actions were undertaken to support integration of firms and their activity in the international market.

The most important activities in that area included:

- granting assistance to entrepreneurs with respect to organizing joint business undertakings or projects,
- assistance to entrepreneurs in the area of establishment of consortia,
- assistance to facilitate consolidation of the SMEs sector,
- financial support for participation of Polish enterprises in selected fairs, exhibitions and commercial missions abroad;
- supporting participation of business organizations in the work of international groups and organizations,
- exchange and promotion on the international arena of the best practices tied to support for SMEs.

## **11.6. Instruments of economic policy**

### **11.6.1. Taxes and charges**

#### **Income tax**

##### *A. Personal Income tax, based on general rules (PIT)*

The basic form for taxing revenues of entrepreneurs who are natural persons (sole proprietors) is the taxation according to the progressive tax scale (19%, 30% and 40%, depending on the income bracket). As of 2004, an indi-



vidual managing business activity can choose the flat rate of 19%, by submitting a relevant written statement to the head of the respective tax office. Introduction of the 19% tax rate was coupled with liquidation of a number of tax allowances and deductions. A taxpayer may choose between the progressive tax scale (which allows to use joint taxation with a spouse) and the flat rate tax, without allowances and the possibility of joint taxation<sup>55</sup>. The fact that over 192.8 thousand taxpayers chose this form of taxation is a proof that the flat rate tax turned out to be an attractive solution for small and medium-sized enterprises<sup>56</sup>.

### *B. Lump sum tax on registered revenues*

This form of taxation is available to taxpayers who, in the year preceding a given fiscal year, obtained revenues on business activity conducted in the form of sole proprietorship, in an amount not exceeding EUR 250,000. Rates depend on the type of activity and can amount to 3%, 5.5%, 8.5%, 17% and 20% of earned revenues. The attractiveness of lump sum taxation compared to other forms is based primarily on a simpler procedure for tax settlements. The benefits are limited, if it turns out that the lump sum rates are set too high for the individual types of activity.

In recent years, a decreased interest in this form of taxation is observed among entrepreneurs. In 1994–2002, the number of persons using the lump sum tax method was reduced by half, to 600 thousands. This is caused by a high level of rates for many types of activity, especially those with a high proportion of costs (such as hotel services).

### *C. Tax chart*

The tax chart is available only to taxpayers conducting business as sole proprietors, and under the civil partnership, obtaining revenues on some specific

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<sup>55</sup> Full application of allowances determined the tax rate for entrepreneurs from the 1<sup>st</sup> tax bracket on the level of 13%, for 2<sup>nd</sup> bracket – 17%, and for 3<sup>rd</sup> – 27%. Thus, introduction of a uniform PIT rate coupled with elimination of allowances is favourable (taking into account only the effective tax rate) for taxpayers under the 3<sup>rd</sup> tax bracket, and for those from the upper reaches of the 2<sup>nd</sup> tax bracket.

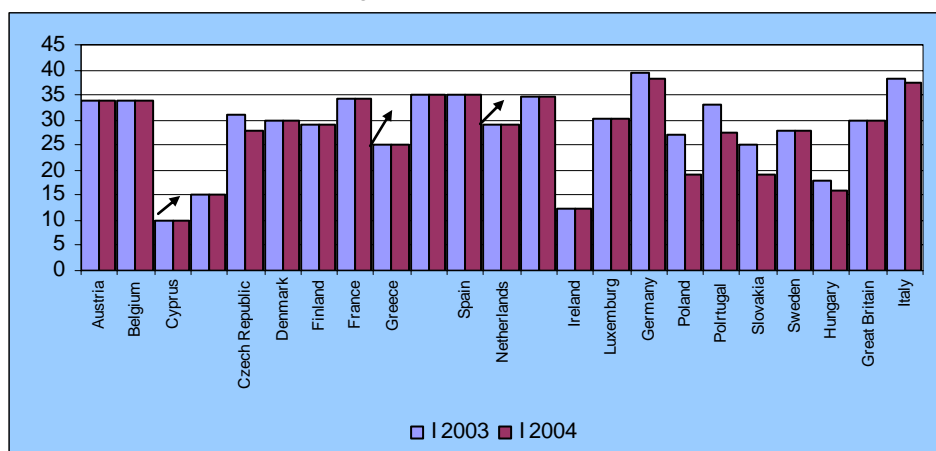
<sup>56</sup> This means that for many of them the benefits resulting from simplification of the system were smaller than the losses tied to elimination of allowances.

types of activity. The law sets forth monthly revenue sums, depending on the type of business eligible for taxation by tax chart, on the size of town where business is conducted, and on the number of employees.

#### *D. Taxation of income of legal persons – Corporate Income Tax (CIT)*

The corporate income tax is applied primarily to legal persons; and the object of taxation is the income irrespective of the sources from which it is obtained (in specific cases, revenue is taxed). As the „Tax strategy” proposed that all entrepreneurs, regardless of their form of business activity, should be taxed with the unified rate of income tax amounting to 19%, as of 1 January 2004 all CIT taxpayers pay their taxes according to the reduced 19% rate. Previously the CIT rate amounted to 27%. The rate of CIT introduced in Poland in 2004 is one of the lowest rates in Europe.

**Chart 34. Tax rates for income of legal persons – Corporate Income Tax (CIT)**



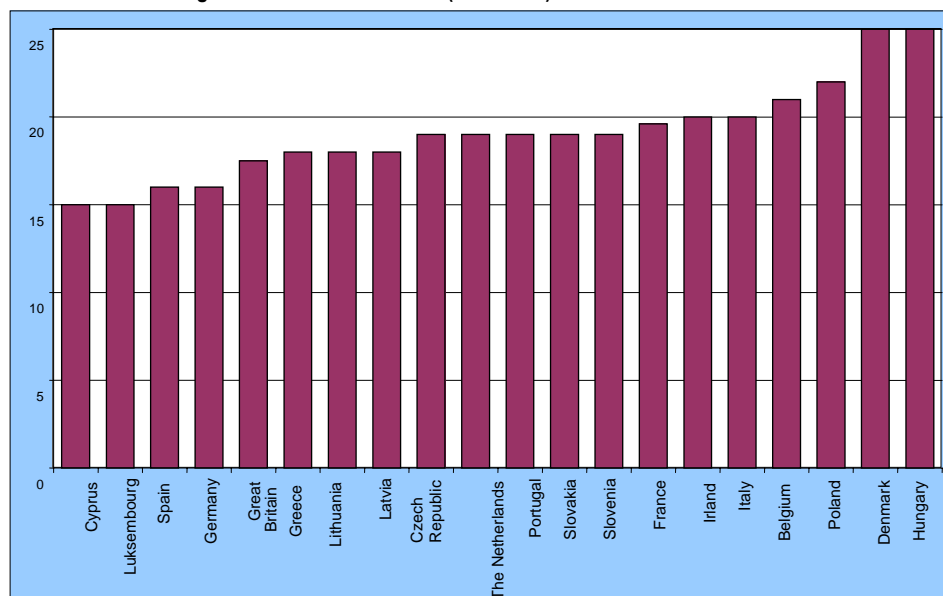
Source: KPMG.

#### **Tax on goods and services (VAT) and the excise duty**

Indirect taxes are relatively the most neutral form of taxation (having the smallest influence on allocation of production factors). At the same time, their administration (especially of the VAT) is costly, and the costs are fixed regardless of tax rates. This means that the cost of earning the income of PLN 1 decreases as the tax rate grows. That is why the basic rates of VAT are relatively high

across Europe, ranking from 15% to 25%<sup>57</sup>. Poland with its 22% VAT rate is one of the countries with the highest rates, next to Hungary and Denmark<sup>58</sup>.

**Chart 35. Tax on goods and services – VAT (basic rate)**



Source: *Vat rates applied in the member and accession states of the European Community, DOC/2402/2003 – EN, European Commission, October 2003.*

### Real Estate Tax

The object of real estate tax is land, buildings or their parts, as well as constructions or their parts, used with relation to business activity. As of 2003, municipal councils may differentiate the rates of the real estate tax on the basis of various market criteria (such as location of the real estate). In practice, municipi-

<sup>57</sup> In all European countries, VAT is an important source of budget revenues.

<sup>58</sup> It is worth noting that many countries apply reduced, preferential rates: Sweden 12% and 6%, Denmark 25%, Hungary 15% and 5%, Great Britain 5%, Ireland 12.5%, 4% and 0 %, France 5.5% and 2.1%, Spain 7% and 4%. In Poland, three reduced rates are applied (7%, 3% and 0%), but the number of goods and services covered by preferential rates is reduced systematically. As VAT revenues constitute 45% of the tax revenues of the state budget, any changes in the rates of that tax cannot lead to their significant decrease. Thus, reduction of the basic rate is not possible without reducing expenses, or without removing the reduced rates.

palities do not very often consider this tax to be a tool for the local policy for supporting entrepreneurship and an instrument that can determine the value of a real estate. They apply the highest possible rates and very rarely grant allowances. This results from weak financial situation of local governments, and from the fact that the real estate tax constitutes about one third of the revenues of municipalities. The target form of real estate taxation, that would allow local governments to form appropriate policy, would be the cadastre tax. For technical reasons, it cannot be introduced earlier than in 2010.

### **Charges on business activity tied to transportation**

Transport seems to be that area of business activity which is the most burdened with formal requirements and the resulting financial charges tied to: tax on the means of transportation, fees for the license to perform transport services, fees for traveling on national roads, fees for examination, fees for issuing certificate of professional competencies, etc. Tables of fees (and penalties for breaches of regulations) are very extensive, and the applied rates vary – up to very high amounts, which can result even in bankruptcy of a company.

### **Other charges on business activity**

Other charges paid by entrepreneurs in the course of their business activity include: stamp duty, fees tied to protection of the natural environment, levies constituting costs of labour, fees for the granting of various licenses, as well as fees for the performance of various administrative actions.

### **Box 7. Other main charges, borne by entrepreneurs:**

#### Stamp duty

The rates of stamp duty are varied. They are low in the case of dealing with various civil matters, and high in the case of fees tied to business activity, especially fees tied to investment projects. Stamp duties are calculated more as source of revenues for municipalities than the coverage of costs of administrative activities.

Charges tied to environment protection

- fees for the use of natural environment,
- fees tied to permits on the above mentioned licenses,
- product fees for the individual types of packaging and products,
- fees for granting the right to use land covered with water for the operations of equipment tied to: water-powered energy generation, water transportation, excavation of sand, gravel and stone, removal of plants, construction of bridge pillars and heads, water intakes, outlets for water and sewage, construction of damming up and sluicing devices, recreational activity, infrastructure for harbors, hotels, gastronomy outlets etc., where the annual rates can reach up to PLN 25 per 1 square meter.

Levies constituting labour costs:

- retirement insurance (the employer's portion),
- disability pension insurance (the employer's portion),
- accidents insurance,
- Labour Fund,
- Fund of the Guaranteed Employee Benefits,
- State Fund for Rehabilitation of the Disabled.

Other fees incurred by entrepreneurs

- fees for activities of technical supervision,
- annual fees paid by power companies which were granted licenses,
- fees for trade in alcoholic beverages, on the basis of law of 26<sup>th</sup> October 1982, on upbringing in sobriety and counteracting alcoholism,
- fees resulting from the Mining and Power Law,
- fees for activities performed by bodies of the administration of measures, and subordinate offices,
- various fees for certification.

**Box 8. Tax strategy – fundamental provisions**

The government document, which sets forth the complex and long-term fiscal strategy, is the „Tax Strategy”, adopted by the Council of Ministers in January 2004. This document, aside from a number of detailed solutions for the individual taxes, formulates four principal goals of the target tax system in Poland:

- support of economic growth,
- guaranteeing defined and stable tax revenues,
- socially acceptable spread of tax charges,
- friendliness, transparency, simplification.

In line with these goals, the „Tax Strategy” contains several assumptions, which build the general Framework for the target tax system. The most important ones include:

- Each expense must be analyzed from the perspective of costs, resulting from the levying of taxes necessary to finance it.
- The tax rate should not dominate the discussion on reform of tax system. The effective (not nominal) tax rate is more important, and primarily, focus should be given to the certainty of interpretation of tax law.
- It is possible to change the structure of tax revenues (the share of direct and indirect taxes) and the “tax-like” revenues, including change of their share.
- Simplification of the tax system should be promoted, even at the cost of worse matching to the specific situation of the taxpayer.
- During a discussion on the target model, systemic changes occurring in the neighbouring countries should be also taken into account, as they are our main competitors when it comes to attracting investment.
- It is absolutely indispensable for the Finance Ministry to introduce solutions that guarantee the certainty and stability of tax laws.
- The reform should be conducted under cooperation of the Finance Ministry with the communities of tax advisors and business.

### **11.6.2. Depreciation charges**

In 2003, depreciation applied to fixed assets and intangible fixed assets, whose estimated time of use is longer than 1 year; and whose starting value was higher than PLN 3,500. Depreciation charges were made on the basis of depreciation rates, published in the List of Depreciation Rates. The rules enabled payers of income tax to increase or decrease the depreciation rates, and also to set them on individual basis for the used or improved fixed assets, introduced for the first time into the inventories of the given taxpayer, or investments in external fixed assets admitted into usage, provided that the minimum depreciation periods defined in the law are adhered to. During the first year in which factory-new fixed assets from the 3–6 groups of the Classification of Fixed Assets are introduced into the inventory, the taxpayers can make depreciation deductions of 30% of the value of these assets. It is also possible to make depreciation deductions not only on a monthly basis, but also at the end of every quarter, or in a single move at the end of the fiscal year.

### **11.6.3. Pledges and guaranties of the State Treasury**

The pledges and guaranties of the State Treasury are granted on the basis of provisions of the law of 8 May 1997, on the pledges and guaranties issued by the State Treasury and some legal persons (Journal of Laws no. 79, item 484 with subsequent amendments). The law regulates the general rules, conditions and mode for:

- the provision of pledges and guaranties by the State Treasury, creation of the asset resources of the State Treasury and performance of obligations tied to these titles,
- the granting of pledges and guaranties by some legal persons,
- the granting by the Bank Gospodarstwa Krajowego pledges and guaranties from the resources of the National Credit Guarantee Fund.

The total amount of pledges and guaranties of the **State Treasury** issued in 2003 amounted to PLN 4.3 billion. This constituted 18.93% of the statutory limit, and 65% of the value of pledges and guaranties provided by the State Treasury in 2002.

#### **11.6.4. Special Economic Zones**

**Special Economic Zones (SEZ)** are one of the instruments for financial and organizational support for new investments. There are 14 Special Economic Zones in Poland, and their total area amounts to 6.3 thousand hectares. An entrepreneur undertaking new investment projects within a SEZ, on the basis of a special permit, uses public aid in the form of exemption from income tax.

Until the end of 2000, the rules and conditions for operations within the SEZ, defined by the law of 20 October 1994 on *Special Economic Zones* (Journal of Laws no. 123, item 600, with subsequent amendments) differed significantly from standards of the European Union. For this reason, these regulations have been adapted to EU legislation with the amendment of the law on SEZ, introduced in November 2000.<sup>59</sup>

Until the end of 2003, 377 entrepreneurs commenced operations in the SEZ. They have created 62,000 jobs, and invested PLN 15.4 billion. From 1 January 2001 until 31 March 2003 – under the new rules – 145 permits were issued. These permits will lead to the creation of 8.92 thousand new jobs, and investment outlays tied to them would reach the total of PLN 2.98 million. So far, investment outlays made on the basis of the “new permits” amount to PLN 750 million and employment reached 5.33 thousand persons.

#### **11.6.5. Customs duties**

The Customs Tariff applied in 2003 was based on the provisions of art. 13 of the Customs Code, similarly as during the previous years. The Customs Tariff maintained the existing, general rules for setting and levying the customs rates. The tariff defined five types of customs duty rates: autonomic, conventional, preferential, lump sum and reduced.

- In 2003, in the case of WTO, there were no reductions of the customs rates, as the last one provided for in the schedule, resulting from liberalization of customs duties for goods covered by the Information Technology Agreement (ITA) was done on 1 January 2002.

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<sup>59</sup> The draft law states that the rules negotiated for entrepreneurs who hold permits issued from 1995 to 2000 would become effective on the date when Poland joins the EU. On the basis of the law, on 30 March 2004 the Council of Minister adopted secondary legislation, which amended regulations regarding establishment of all 14 Special Economic Zones.



- The level of customs duties for goods originating in the European Union and in EFTA member countries did not change.
- With respect to goods originating in the CEFTA countries, customs duties on industrial goods remain unchanged (the 0% customs rate was applied). For agricultural products, the levels of customs duties, resulting from the negotiated lists A, B and C of the CEFTA Agreement have been maintained. The exceptions were limited concessions contained in the Customs Tariff, for wheat and maize imported from the Czech Republic and Slovakia, sugar syrup imported from the Czech Republic and Slovakia; starch and starch products from the Czech Republic, Slovakia and Hungary; butter from the Czech Republic; tomato concentrate from the Czech Republic and Slovakia; and white sugar imported from the Czech Republic and Slovakia. They were introduced and notified to the CEFTA countries in 1997, 1998, 1999 and 2000, as import of these products caused excessive disturbances for domestic producers (art. 14 of the CEFTA agreement). As a result of negotiations with Hungary, the 2003 Customs Tariff contains preferences for Hungarian products – pork and poultry meat, wheat and tomato concentrate - which result from the CEFTA Agreement.
- With respect to goods imported from Lithuania, Latvia, Israel, Estonia, Turkey, Croatia and Faeroe Islands, customs duties on industrial goods remain unchanged (the 0% customs rate was applied). For agricultural goods, with respect to some of them, next stages of customs duties liberalization were applied.

**Box 9. Changes in the area of customs duties as of 1 January 2004**

Compared to 2003, the Customs Tariff valid in 2004 (during the pre-accession period, that is until 30 April 2004) took into account:

- in the case of goods originating in the European Union – change of the level of customs duties with relation to reduction of customs rates on processed agricultural goods (including certain items from sections: 13, 15, 20 and 21), resulting from Protocol 3 to the European Treaty.
- in the case of goods originating in CEFTA countries – in view of decisions made in Bled in July 2003, customs preferences were restored for the Czech Republic and Slovakia for wheat and maize, the 2004 Tariff maintained the

withdrawal of preferences for Slovenia on tomato concentrate, confectionery products and grape juice, which were introduced in 2003.

- For goods imported from Lithuania, as this country applied protective measures to import of pork from Poland, the withdrawal of preferences for import of milk and cream, introduced in 2003, was maintained for 2004.
- For goods imported from Turkey, the 2004 Tariff maintained the withdrawal of preferences for the import of certain textiles, which were introduced in 2003.

#### 11.6.6. Financial instruments of support for export

The instruments meant to support export include:

- **Guaranties and pledges for export undertakings<sup>60</sup>** may be granted on behalf of the State Treasury, provided that the credit covered with them is designated to finance investment projects which guarantee to develop export of goods and services. The pledges and guaranties may be granted by the National Credit Guarantee Fund, managed by the Bank Gospodarstwa Krajowego.
- **State Guaranties for insurance of export contracts<sup>61</sup>** may apply to: export credits, export contracts, direct investments made in foreign countries, as well as to the costs of searching for foreign outlet markets. The Export Credit Insurance Corporation KUKI S.A. provides them in the form of direct or indirect insurance, or the provision of insurance guaranties.<sup>62</sup>
- **Subsidies to interest rates on export<sup>63</sup>** can be obtained by banks which offer export credits. The subsidies are paid by the State Budget. This instrument enables to stabilize the interest on export credit on the level of fixed *Commercial Interest Reference Rate – CIRR*.

<sup>60</sup> The law of 8 May 1997, on pledges and guaranties issued by the State Treasury and some legal persons (Journal of Laws no. 174/2003, item 1689).

<sup>61</sup> The law of 7 July 1994, on export insurance guaranteed by the State Treasury (unified text – Journal of Laws no. 59/2001, item 609).

<sup>62</sup> The Export Credit Insurance Corporation KUKI S.A. insures the export receivables, guaranteed by the State Treasury, within the limit of funds determined under the budget act. In 2003 this limit amounted to PLN 6.5 billion; and in 2004 it was raised to PLN 9.5 billion. In 2003, the portion of Polish export insured by KUKI S.A. amounted to 3.17% of GDP, and the statutory limit was used in 65%.

<sup>63</sup> The law of 8 June 2001, on subsidies to interest rates on export credits with fixed interest rates (Journal of Laws no. 73, item 762).

- **Government credits designated for the financing of export of goods and services** – the credits in the form of the so-called tie-in aid enable the financing of contracts for deliveries of machinery, equipment and materials produced in Poland to the recipient country. This applies also to export of services and technology. Individual deliveries apply to the areas agreed by governments of both parties, and fall within the decisions and limitations imposed by the Organization for Economic Cooperation and Development (OECD). The borrower of that credit can be only a country from the group of poorest countries of the world<sup>64</sup>.

In 2003, three government contracts were valid for credits under the tie-in aid system:

- for the People's Republic of China (USD 85 million);
- for Serbia and Montenegro (USD 50 million);
- for the Uzbekistan Republic (USD 15 million).

In 2004, further financing of investment projects in these countries is planned, with the use of the above listed government credits. The following aid credits are also considered:

- for the Uzbekistan Republic (USD 15 million),
- for the Moldova Republic ( up to USD 15 million),
- for the Socialist Republic of Vietnam (up to USD 90 million).

#### **11.6.7. Financial support for investment**

The basis for granting financial support for new investment undertakings is the law of 20 March 2002, on financial support for investment (Journal of Laws no. 41, item 363 and no. 141, item 1177), which came into force on 20 May 2002, and secondary legislation:

The law defines the rules and forms for support, granted by the minister competent for the economy, to entrepreneurs commencing new investment undertakings, or creating new jobs tied to these investments.

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<sup>64</sup> Complying with the requirement of the World Bank which states that Gross Domestic Product per capita may not exceed the level which makes it impossible to use the 17-year credits granted by the World Bank.

According to the legal status in 2003, financial support could be granted to:

1. an entrepreneur making a new investment: whose value does not exceed 50% of the maximum allowable volume of public aid, for the creation of new jobs, for training,
2. a municipality, for the development and modernization of technical infrastructure, directly tied to the supported investment project of a specific entrepreneur.

#### **Box 10. Conditions for supporting a new investment project**

According to regulations, financial support may be granted to an entrepreneur making a new investment, if this investment meets one of five conditions listed in the law, that is:

- the value of the new investment is not lower than the equivalent of 10 million euro, or
- the value of the new investment is not lower than 500,000 euro in cases, where the investment applies to a development or modernization of an existing enterprise; and saves at least 100 jobs, or 50 jobs in case where the investment is made in one of the support areas, for a period not shorter than 5 years; or
- the new investment leads to the creation of at least 20 jobs for a period not shorter than 5 years; or
- the new investment introduces a technical innovation; or
- the new investment improves the condition of natural environment.

On the basis of amendments to the said law of 29 August 2003, (Journal of Laws no. 159, item 153), the sixth condition was introduced:

- the new investment is located within the territory of an industrial or technological park.

The applications for aid are evaluated on the basis of the criteria defined in the law and in secondary legislation, that is: location of the new investment; size of the new investment; volume of employment; expected economic effectiveness

of the new investment; impact on natural environment; impact on economic activation of the region; the innovative nature of the technology used to produce goods and services under the new investment; compliance of the new investment with areas designated as priorities on the basis of observing technology development tendencies.

In 2003, formal requirements were met by 274, which were considered. The applications were analyzed in two batches. After analyzing the applications for financial aid for new projects, and taking into account the opinion of the Team on Granting Financial Support to Entrepreneurs, and the President of the Office for Competition and Consumers Protection, the minister in charge of economy finally approved and signed contracts with 11. The total value of financial support for new investment, granted in 2003, amounted to PLN 101,499,898.

#### **11.6.8. Promotional activity of the Ministry of Economy and Labour**

In 2003, the Ministry of Economy and Labour conducted numerous activities, which goal was to create a positive image of the Polish economy, development of foreign economic cooperation and the growth of Polish export. This is performed through organization of promotional events, using primarily the assistance of economic and commercial sections of Polish embassies and consulates, as well as through providing support for promotional activities undertaken by entrepreneurs or business organizations. These activities focus on:

- financial support for participation of Polish enterprises in **international fairs and exhibitions** (in 2003, 1,850 participants),
- financing participation of Polish enterprises in **commercial missions abroad**, tied to participation in fairs and exhibitions abroad, and the costs of organizing in Poland **visiting missions of potential importers** of Polish goods (in 2003, about 150 missions were organized. Financing was made available for about 800 of firms participating in, or organizing these missions),
- Financial support for promotional activity of **Polish Homes** abroad: PH – Agricultural Technology and PH – Food Articles in the Czech Republic (they are both located in Czech Cieszyn – Mosty); and organization and promotional activity of the Commercial Polish Home in Moscow,

- purchase and distribution of **information and promotional materials** for the Ministry and the economic and commercial sections of embassies and consulates; financial support for the publication of such materials, produced by external entities (often in cooperation with and support from the Ministry), primarily by business organizations,
- **promotional activities of the economic and commerce divisions** of embassies and consulates of the Republic of Poland. They focus on promotion of Polish export and foreign investments in Poland. Their duty is to prepare analyses of markets and areas of activity, analyses of regulations; organization of seminars and conferences; participation in fairs and exhibitions (primarily those where no Polish representatives participate), publishing activity. These divisions are responsible for macroeconomic representation of Polish interests abroad. They are increasingly involved in supporting small and medium-sized enterprises in their business contacts in the respective countries,
- **establishment of the Export Promotion Portal** (30 April 2003).

#### Box 11. Export Promotion Portal

The Export Promotion Portal integrates the scattered business-related Internet resources, important for Polish exporters, and makes them available via an Internet portal: [www.eksporter.gov.pl](http://www.eksporter.gov.pl). The system contains information on export profiles of Polish firms; export queries from other countries; offers of Polish exporters; the opportunities for selling Polish goods in international markets; conditions for access to international markets (both in terms of geography and sectors); and on the mechanisms for export support, available for entrepreneurs.

- financing of the costs of **conferences, seminars and other promotional events** (domestic and abroad), dedicated to issues of economy, promotion of the Polish economy and export, opportunities and conditions for developing export to specific markets or by specific sectors, organized primarily by business organizations, often in co-operation with local authorities and foreign partners, including the economic and commercial sections of embassies and consulates. The Ministry also collaborates with organizers of such events on

issues tied to their contents. Representatives of the Ministry participate in such events as guest speakers,

- **support for selective aid programmes** – selective, focused on individual sectors, promotional projects undertaken by groups of entrepreneurs with the view of promoting specific commodities and product groups with high potential, targeted at markets with high absorption levels. Assistance offered under the Programme includes financial support – in the form of target subsidies – for the costs of executing selective promotional projects. Such projects are undertaken by a group, or for a group, of at least five Polish entrepreneurs. In 2003, the financing was provided for 21 such projects, primarily in the light industry, food processing industry, production of furniture and the medical services sector,
- financing the costs of participation in training under the **Foreign Trade Academy**. In 2003, under FTA, 95 training projects were financed.

#### **Box 12. Foreign Trade Academy**

The purpose of this project is to facilitate the Polish entrepreneur's access to training regarding organization and techniques of foreign trade. FTA is built on the basis of the existing academic and training institutions, on three levels of education: postgraduate studies, foreign trade college and vocational development courses.

- financing of part of costs tied to obtaining certificates for products, required in the foreign markets. Under the programme, the following costs were financed:
- certificates of conformity with the requirements defined in the standards of a given foreign market, the Common Market of the European Union (such as the CE certificate), and with international requirements,
- certificates required for commodity trade in foreign markets, such as veterinary certificates or hygienic certificates,
- service for the inflow of foreign direct investment (PAIZ S.A. / PAIIZ S.A.).

### 11.6.9. Public aid granted to entrepreneurs, compared with countries of the EU-15

Growing competition in international markets entails the need to improve productivity and effectiveness of the Polish enterprises. An important role in that respect is played by properly targeted and closely controlled **public aid**, which is used according to the intentions.

In general, the provision of aid financed with public funds to entrepreneurs is considered as contrary to the rule of economic freedom and the common market rules, as it offers privileges to some at the cost of others<sup>65</sup>. Thus, the laws of the EU regulate in details the conditions (uniform across the Community) for providing such aid. Regulations define in detail the issues of admissibility, scope, and procedures for granting funds and monitoring their use<sup>66</sup>.

The current solutions allow for granting aid only on an exceptional basis, in strictly defined situations. This restriction does not apply to the so-called insignificant aid, whose value in the course of three subsequent years does not exceed EUR 100,000 (the *de minimis* rule), and which is allocated only to entrepreneurs operating in the local markets – provided that this aid does not apply to export of goods and does not favour domestic products over imported ones.

It is admissible to provide aid designated for: the removal of disturbances of larger than sectoral scope which appear in the economy; for undertakings executed to foster European interests; for the promotion of culture, science and education; and to compensate the entrepreneurs costs tied to execution of public tasks. The following categories of aid are deemed admissible:

- **horizontal**, which may be addressed to all entrepreneurs (regardless of the location of their business and sector in which they operate),
- **regional**, designated for the poorest regions of the Community,

<sup>65</sup> Article 87 of the Treaty establishing the European Community states that any form of aid granted by the state or coming from state sources (regardless of its form), which distorts competition by granting privileges to some enterprises or sectors of the economy does not comply with the rules of the common market.

<sup>66</sup> The law of the European Union regarding public aid corresponds with the rules on subsidies, determined under the agreement on subsidies and countervailing measures, adopted by the World Trade Organization and binding for all its members. This agreement introduced transition periods for countries in systemic transformation (this included Poland), for 1997–2001, where derogation from its rules was possible. After the end of the transition period, Poland has to follow the same rules as other developed countries of the WTO.



- **sectoral**, targeted at the restructuring of economic sectors which are in particularly difficult situation.

The above named three types of public aid intersperse in practice, mainly because they use a common set of instruments.

The actual impact of public aid on competitiveness of an enterprise is largely dependent on the manner of its usage, which in turn results from the strategy of the company. From the perspective of entrepreneurs, a decision to use public funds for research and development funds means the choice of more difficult strategies, carrying a higher risk. Public aid does influence directly the increase in innovation, economic effectiveness and increases the enterprise's skills to adapt to changes occurring in market conditions. In its competitiveness studies the European Commission points out in particular the issues of quality and skills of management. It also stresses the close ties of the causal nexus between the enterprise's ability to develop intensely, and public aid granted for research and development works.

### **Volume of public aid**

When performing a comparative analysis of the structure of public aid granted to entrepreneurs in Poland and in countries of the EU-15, we must remember differences in methodology<sup>67</sup>.

The total value of aid granted to entrepreneurs in 2002 in the countries of the EU-15 amounted to EUR 49 billion. The largest portion was allocated to Germany (13 billion), France (10 billion) and Italy (6 billion). In relation to the GDP, the volume of aid in the EU-15 reached the level of 0.56%<sup>68</sup>, and ratios for indi-

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<sup>67</sup> As the reporting of institutions which provide aid in Poland is not adapted to the EU standards, and there is no data available, the classifications presented in reports on public aid have many gaps. Polish reports take into account aid granted to business entities of the respective sections of the Polish Classification of Business Activity (EKD), and separate production activity, mining, transport and agriculture (from October 2002). Contrary to the reports of the European Commission, they do not state separately the funds allocated for financial services, tourism, culture or media. The analyzed periods are also different. In the EU, data is presented in overlapping, 3-year periods (such as 1996-1998 and 1998-2000), Poland, presents the data for individual years only. It is worth noting that public aid presented in the statistics of the EU does not include funds allocated for railways. Under the Polish methodology, these funds are shown under public aid and constitute its significant part – in 2002, about 20%.

<sup>68</sup> Without aid provided to the railway sector.

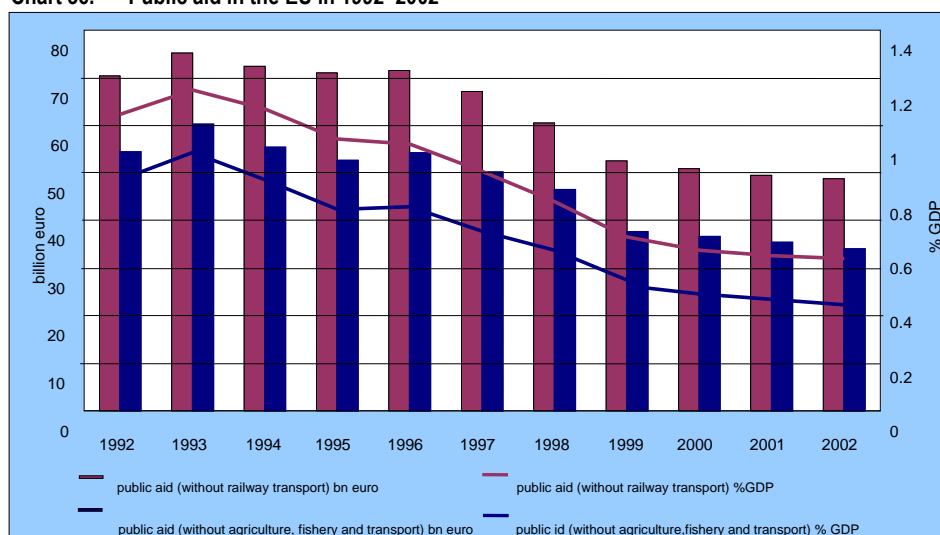
vidual countries differ. In 14 countries, a clear downward trend of aid volume was registered. The largest reduction of aid in relation to the GDP was recorded in Ireland (as one of the results of changes in fiscal policy); and in Portugal, where the regional aid – supporting primarily financial institutions – was sharply reduced. Only in Denmark the aid resources were increased. This is tied to the implementation of programs for employment promotion and protection of natural environment.

**Table 68. Public aid in countries of the EU-15 in 2002**

|   | EU-15          | Belgium | Denmark | Germany | Greece | Spain | France | Ireland | Italy | Luxembourg | The Netherlands | Austria | Portugal | Finland | Sweden | Great Britain |
|---|----------------|---------|---------|---------|--------|-------|--------|---------|-------|------------|-----------------|---------|----------|---------|--------|---------------|
|   | (billion Euro) |         |         |         |        |       |        |         |       |            |                 |         |          |         |        |               |
| Public aid (without railway sector)                     | 48.8           | 1.3     | 1.6     | 13.3    | 0.7    | 4.3   | 9.7    | 1.0     | 6.0   | 0.1        | 1.9             | 1.3     | 1.0      | 1.7     | 1.0    | 3.9           |
| Public aid (without agriculture, fishery and transport) | 34             | 0.9     | 1.3     | 11.4    | 0.4    | 3.5   | 6.2    | 0.5     | 4.5   | 0.1        | 0.8             | 0.5     | 0.6      | 0.2     | 0.4    | 2.6           |

Source: State Aid Scoreboard spring update, Commission of the European Communities, Brussels, COM (2004) 256 final.

**Chart 36. Public aid in the EU in 1992–2002**



Source: State Aid Scoreboard spring update, Commission of the European Communities, Brussels, COM (2004) 256 final.

In 2002, public aid allocated to Polish entrepreneurs, amounted to PLN 10.3 billion, which was about EUR 2.7 billion<sup>69</sup>. Despite the fact that the aid in nominal terms was much smaller than in Germany, France, Italy or Spain, it was higher than volume of aid provided in Ireland or Greece. At the same time, effective aid for Polish entrepreneurs (as percentage of GDP) was still higher than in the „old” member countries of the EU. The provided assistance constituted 1.3% of the GDP, compared to 1.5% in 2001. It should be noted that the actual amount of aid granted to entrepreneurs in Poland from public funds was – as one could assume – much higher<sup>70</sup>.

The significant differences between Poland and the EU are also suggested by the review of public aid according to the groups of instruments used to implement it<sup>71</sup>.

**Table 69. Structure of public aid in Poland and in the EU, per forms of aid (%)**

| Forms of aid                              | Poland |      |      |      | EU average annual <sup>72</sup> |           |
|---|--------|------|------|------|---------------------------------|-----------|
|   | 1999   | 2000 | 2001 | 2002 | 1998–2000                       | 2000–2002 |
| Group A.1. Subsidies (payments)           | 32.8   | 46.0 | 25.6 | 37.8 | 63.1                            | 58.6      |
| Group A.2. Tax subsidies                  | 53.2   | 38.5 | 31   | 26.9 | 25.0                            | 24.0      |
| Group B. Capital and investment subsidies | 2.6    | 1.5  | 0.2  | 0.3  | 0.6                             | 5.6       |
| Group C. Soft loans                       | 8.2    | 11.4 | 20.3 | 11.5 | 8.4                             | 8.6       |
| Group D. Pledges and guaranties           | 3.2    | 2.6  | 16.1 | 21.8 | 2.8                             | 3.2       |
| Other                                     | -      | -    | 6.9  | 1.6  | -                               | -         |
| TOTAL                                     | 100    | 100  | 100  | 100  | 100                             | 100       |

Source: State Aid Scoreboard spring update, Commission of the European Communities, Brussels, COM (2004) 256 final; Report on public aid granted to entrepreneurs in Poland in 2002, Office for Competition and Consumers Protection, Warsaw, October 2003.

<sup>69</sup> Assuming the average exchange rate of the EUR in 2002, EUR 1 = PLN 3.8557.

<sup>70</sup> UOKiK stresses that some bodies still do not comply with their statutory obligations and do not provide annual reports on the granted aid.

<sup>71</sup> In the annual reports (both Polish and the EU), public aid is classified according to the following groups of instruments: A (A1 and A2) covers subsidies and tax allowances, B (B1 and B2) – capital and investment subsidies; C (C1 and C2) – the so-called soft loans – preferential credits and deferred taxes; and D (D1) – credit pledges and guaranties. The letters mean that: 1 – the source of aid funds are the budget expenses, and 2 – reduction of the due budget revenues. Only in the case of group A, the whole amount constitutes direct and non-returnable support for business entities. In the other groups, the so-called aid element is estimated.

<sup>72</sup> Applies to public aid designed for enterprises of the production activity sector.

In the context of analysis of public aid, it is necessary to assess what portion of aid for business entities constitute direct expenses from the state budget (subsidies, capital and investment subsidies, preferential loans and credit guarantees), and what portion is attributed to passive aid – resignation from due revenues of the state budget. In the EU, active direct aid is preferred – its share constitutes about  $\frac{3}{4}$  of expenses for these purposes. In Poland, the proportions are reversed<sup>73</sup>.

### **Areas for allocation of public aid**

In Poland and in the EU, the share of horizontal aid in all public aid was the highest, compared to other categories of admissible aid. Due to serious differences in reporting systems, and also in the methodology for qualifying specific aid granted to enterprises to the various categories of aid, it is hard to perform a credible comparison between the situation of the EU-15 and Poland in terms of the goals for which public aid is allocated. The data suggests that the role of horizontal aid in Poland is smaller. At the same time, the structure of public aid in the countries of the EU-15 does not contain data on aid for the agriculture sector, while its volume is significant (EUR 13.1 billion paid in 2000–2002, from the total of EUR 49.7 billion). If this element is excluded from Polish public aid, the share of horizontal aid becomes much higher (56–60%). Under such circumstances, the share of sectoral aid would also rise (in 2001, it amounted to about 40%). Compared to the situation in the European Union, the share of regional aid in Poland still is relatively low.

It is worth stressing that regardless of the methodology of calculations, it is visible that both in the EU-15 and in Poland the aid is becoming re-oriented. Every year the scope of aid granted to enterprises from the so-called special sector diminishes, while the importance of horizontal goals and regional aid grows. The use of aid in the latter two areas is an important tool of the cohesion policy.

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<sup>73</sup> This results partly from the level of economic development and from the capacities resulting from the situation of Poland's public finances. It should be pointed out that the role of pledges and guarantees as effective form of public aid is rising.

**Table 70. Structure of public aid in Poland and in the EU, per allocation (%)**

| Allocation of aid         | Poland <sup>74</sup> |       |       |       |       | EU <sup>75</sup> |       |
|---------------------------|----------------------|-------|-------|-------|-------|------------------|-------|
|                           | 1998                 | 1999  | 2000  | 2001  | 2002  | 2000             | 2002  |
| Horizontal aid            | 40.0                 | 73.5  | 64.4  | 31.9  | 33.6  | 47.0             | 50.0  |
| Sectoral aid              | 59.7                 | 24.2  | 30.1  | 24.1  | 17.9  | 29.0             | 27.0  |
| Regional aid              | 0.3                  | 1.3   | 3.7   | 3.4   | 4.6   | 22.0             | 23.0  |
| Agriculture               |                      |       |       | 21.3  | 17.2  |                  |       |
| Other areas <sup>76</sup> |                      |       |       | 18.9  | 26.3  |                  |       |
| Lack of information       | –                    | 1.0   | 1.8   | 0.4   | 0.5   | 1.0              | –     |
| TOTAL                     | 100.0                | 100.0 | 100.0 | 100.0 | 100.0 | 100.0            | 100.0 |

Source: *State Aid Scoreboard spring update, Commission of the European Communities, Brussels, COM (2004) 256 final; Report on public aid granted to entrepreneurs in Poland in 2002, Office for Competition and Consumers Protection, Warsaw, October 2003.*

The European Commission particularly approves such areas of allocation of public aid as: development of SMEs, research and development, and protection of natural environment (in the EU, several percent is allocated for each of the areas). In the structure of expenses for horizontal purposes in the EU countries, particularly significant is large importance of expenses for research and development works. This applies in particular to Finland, Austria, the Netherlands, Sweden and France. Aid addressed to the sector of small and medium-sized enterprises became a priority primarily in: Luxembourg, Belgium, Italy and the Netherlands. In Denmark, Sweden and Germany expenses for protection of natural environment are the primary focus. In the case of Austria and Spain, we see a relatively high share of training in the overall value of horizontal public aid. In 2002, Denmark focused its aid on employment policy (one third of all aid). The above differences between member countries of the EU prove the differences in the economic policies, especially the preferred development goals.

<sup>74</sup> Data of the period before 2000 is not comparable to data for 2001 and 2002, due to changes in reporting and in methodology for their preparation. In 2001–2002, a significant portion of aid constituted funds allocated for other purposes. In 2001, 21.3%, and in 2002, 17.2% of the aid was allocated to agriculture. The report for 2000 does not cover these amounts, or data on the aid amount may not have been available.

<sup>75</sup> Without aid provided to the agriculture, fishery and the railway sectors.

<sup>76</sup> Such as compensation for execution of public tasks by the entrepreneur; aid granted for the purpose of purchase and storage of agricultural products and stocks of processed products; purchase and storage of marine fish; aid designated to cover the costs of current operations of the entrepreneur, granted in areas which are discussed in art. 12 par. 1 of the law.

In Poland PLN 3.5 billion were designated for horizontal aid in 2002. In nominal terms, this suggests a decline, but as aid for other purposes was reduced, the share of horizontal aid in the total aid volume in Poland in 2002 rose. An analysis of the directions of allocation of these funds shows that they differed significantly from tendencies in the countries of the EU-15. In Poland, most funds in 2001–2002 were used to save and restructure enterprises (about 60%). In 2001, only 3% and in 2002 6.6% of total aid was allocated to the maintenance of current levels of employment or creation of new jobs. This was tied primarily to the processes of employment restructuring in the coal mining and steel sectors. These differences may result from other manner of classifying individual expenses, and including some of them into restructuring aid. The importance of aid allocated for training is growing (in 2002, about 9%). Outlays for research and development and protection of natural environment remain on a low level.

#### **Public aid granted to entrepreneurs in 2003<sup>77</sup>**

At the time when this report was drawn up, full data on public aid in Poland in 2003 was not yet available. The reports of local bodies providing aid were also incomplete, which makes it impossible to present the data broken down per areas or instruments of public aid. According to estimates<sup>78</sup>, public aid granted in 2003 was higher than a year earlier. This is suggested by the significant increase of aid transferred by the Ministry of Finance, offices and tax authorities.

A high increase of public aid, granted in 2003 by the **Ministry of Finance** (including the funds transferred via the tax offices and revenue boards) resulted mainly from the four-fold increase of automatic aid. This increase was due, primarily, to aid granted on the basis of provisions of art. 5 of the law of 28 November 2003, on restructuring of the hard-coal mining sector in 2003–2006 (Journal of Laws No. 210, item 2037), which is tied to the government programme for restructuring the coal mining sector. The value of aid constitutes 58% of the whole automatic aid in 2003.

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<sup>77</sup> Detailed information on public aid granted in 2003 by the Minister responsible for the economy is provided in the Report on Industry.

<sup>78</sup> According to estimates of Office for Competition and Consumers Protection state aid granted in 2003 amounted about PLN 22 billion.

**Table 71. The volume of public aid in 2003, per institutions providing that aid (PLN million)**

| Name of institution  | 2002     | 2003 <sup>79</sup> |
|--|----------|--------------------|
| Ministry of Finance  | 2,100.7  | 1,571.9            |
| Ministry of Economy  | 987.6    | 1,009.3            |
| Ministry of Infrastructure                                       | 292.1    | 146.0              |
| Ministry of Agriculture  | 234.4    | 228.5              |
| Ministry of the Treasury   | 59.5     | 170.1              |
| Ministry of the Environment                                      | 602.5    | 0.1                |
| Ministry of Science and Information Technology                   | 108.0    | 89.4               |
| National Fund for Environmental Protection and Water Management  | 42.6     | 240.0              |
| Regional Funds for Environmental Protection and Water Management | 65.6     | 66.9               |
| State Fund for Rehabilitation of the Disabled.                   | 378.9    | 259.9              |
| Social Insurance Institution                                     | 80.9     | 8,618.2            |
| Agency of Agricultural Property of the State Treasury            | 220.3    | 115.7              |
| Agency for Restructuring and Modernization of Agriculture        | 1,241.6  | 969.0              |
| Agricultural Market Agency                                       | 633.3    | 823.1              |
| Industrial Development Agency                                    | 103.5    | 152.0              |
| Polish Agency for Enterprise Development                         | 61.0     | 78.2               |
| Tax offices and Revenue Boards                                   | 2,199.3  | 7,293.7            |
| Marshals of Provinces  | 124.0    | n.d.               |
| County administrators  | 220.9    | n.d.               |
| Municipalities   | 521.0    | n.d.               |
| Total public aid (in PLN million )                               | 10,277.6 |                    |

Source: Office for Competition and Consumers Protection.

At the same time, in 2003 a large portion of the aid was granted under the government package of anti-crisis actions, which includes these two laws: the law of 30 October 2002 on public aid for entrepreneurs of particular importance for the labour market (Journal of Laws no. 213, item 1800), and the Law of 30 August 2002, on restructuring of public receivables from entrepreneurs (Journal of Laws no. 155, item 1287). An increase of allocated aid is a result of designating public funds for: assistance tied to managing business in the Special Economic Zones; assistance for protected workplaces for the disabled; assistance in the form of investment allowances; assistance which constitutes compensation for the performance of public duties.

<sup>79</sup> Preliminary data.

However, in 2003 the **Social Insurance Institution (ZUS)** was the entity, which provided the largest value of public aid – **PLN 8.6 billion**. Over 90% of that amount was public aid granted on the basis of the law of 28 November 2003, on restructuring of the hard-coal mining sector in 2003–2006 (Journal of Laws no. 210, item 2037). It was executed mainly in the form of cancellation of contributions and interest, and spreading those payments into installments or postponing them. Aid of the ZUS was provided primarily to entities from the hard coal mining sector<sup>80</sup> and the steel and iron sector<sup>81</sup>. Entities from other sectors of the economy obtained aid under the law on restructuring legal public receivables from entrepreneurs. In 44 cases, the ZUS decided to cancel contributions or interest, and 3,165 beneficiaries used the option of spreading payments into installments.

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<sup>80</sup> On the basis of the said law on restructuring of the hard coal mining sector in 2002–2003 and the law of 26 November 1998, on adapting the hard-coal mining to functioning under market economy conditions and on special rights and tasks of the mining municipalities (Journal of Laws no. 162, item 1112 with subsequent amendments).

<sup>81</sup> The law of 24 August 2001, on the restructuring of the iron and steel sector (Journal of Laws no. 111, item 1196).





## Chapter 12

# The employed

## 12.1. The employed

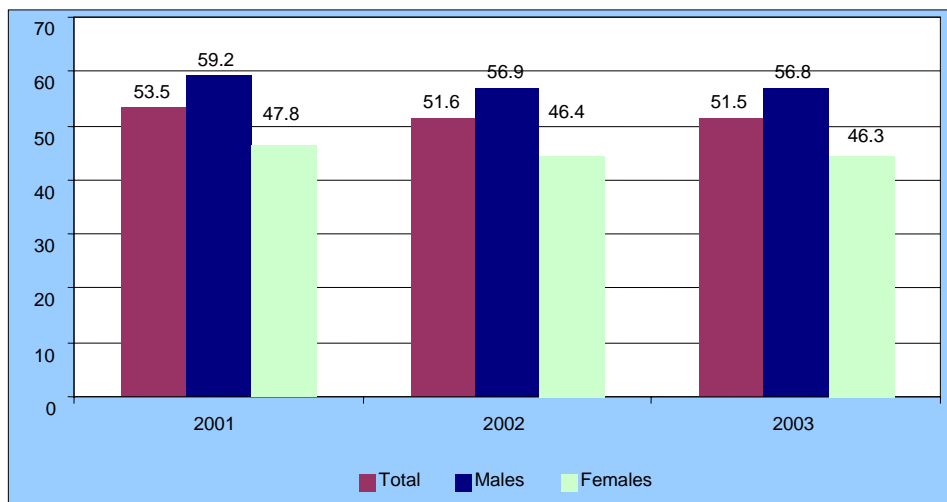
Despite the economic revival in 2003, an increase in the number of employed was not observed – it was lower by 1.2% than in 2002 and amounted to 13,617 thousand persons.

Table 72. The employed aged 15 and over, per economic sectors.

| Period of research | TOTAL    | agriculture | industry | services | agriculture | industry | services |
|--------------------|----------|-------------|----------|----------|-------------|----------|----------|
|                    | thousand |             |          |          | % of total  |          |          |
| 2001               | 14,207   | 2,719       | 4,332    | 7,156    | 19.1        | 30.5     | 50.4     |
| 2002               | 13,781   | 2,663       | 3,947    | 7,170    | 19.3        | 28.6     | 52.0     |
| 2003               | 13,617   | 2,509       | 3,892    | 7,216    | 18.4        | 28.6     | 53.0     |

Source: CSO, BAEL RESEARCH.

The employment ratio, which defines the proportion of employed aged 15–64 to the total population aged 15–64 – reached 51.5%, and remained on the same level as in the previous year. The lowest level of employment is found in the oldest age group (50–64 years), which is the outcome of deactivation policy towards the persons in immobile age, implemented in 1990's. The low ratio of employment in the youngest group can be explained with the fact that the learning period has grown longer, as the educational aspirations of young people are higher. The employment ratio in the age group 25–54 is also low, and is going down systematically. Currently Poland has the lowest level of employment among all countries of the European Union. Given the priorities of the Lisbon Strategy, which speak of increasing employment ratio for the EU countries to 70%, implementation of pro-employment development strategy of the country will be one of the most important challenges of economic policy in Poland.

**Chart 37. Employment ratio for persons aged 15–64**

Source: CSO, BAEL RESEARCH.

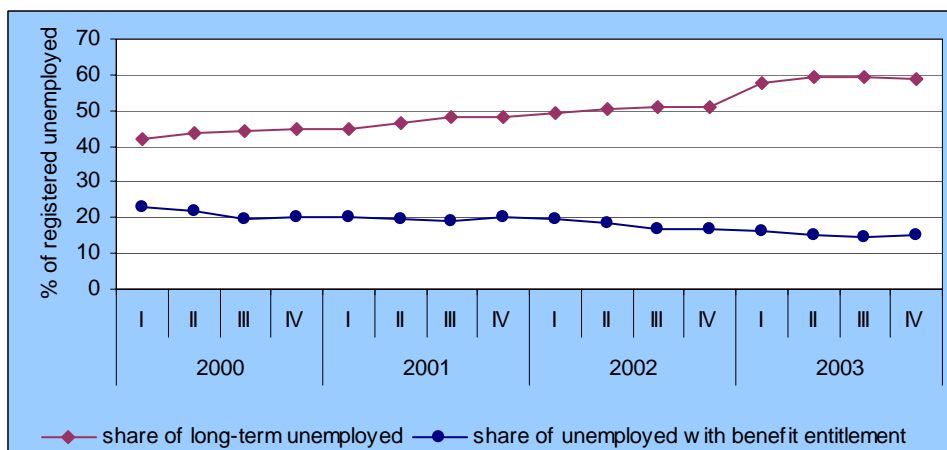
## 12.2. Unemployment and unemployment rate

In 2003, the average number of unemployed in Poland reached 3,344 thousand people, which amounted to 19.6% of all professionally active people. Among women, unemployment rate reached 20.4%, and among men 19.0%. This means that the number of unemployed fell slightly as compared to 2002 – the decrease reached 2.6%. The growing trend in the number of unemployed, observed during the last several years, was stopped.

Statistical data on registered unemployment can serve as an additional source of information on the labour market situation. At the end of 2003, the rate of registered unemployment reached 20.0% and remained on the same level as in 2002. The proportion of persons entitled to unemployment benefits fell, and it was caused largely by the higher share of persons who are unemployed for a long time.

Among the economic factors, which cause the negative situation in the labour market, the most important ones are low level of the economic growth and low level of investment. We can also assume that the first symptoms of economic revival were not convincing enough for the entrepreneurs to make them increase employment.

**Chart 38. The share of long-term unemployed and unemployed with benefit entitlement among the registered unemployed.**



Source: CSO.

It should be stressed that the structural factors are much more important for the situation in the labour market, as they cause economic growth in Poland to proceed without increase in employment. As a result, the natural unemployment rate amounts to more than 15%. Structural problems in the labour market are tied to the following factors:

- low level of education among the unemployed,
- territorial differentiation of the labour market, linked with insufficient geographic and vocational mobility of employees with lower qualifications,
- very low level of services provided by public employment services in the area of employment services.

The barrier for growth of employment is the high „ax wedge” and the resulting high labour costs, coupled with relatively low labour productivity, as compared to labour productivity in the EU. The charges on labour costs play a particularly important role in the case of the least productive persons: employees with low vocational skills, with short job tenure; older or handicapped persons, and the long-term unemployed. The insufficient flexibility of labour regulations is also a factor which limits the growth of employment.

It is worth noting that an increase in labour resources, tied to the appearance in the job markets of young people born in the years of demographic high,

is a chance to increase the dynamics of economic growth. Due to structural barriers, this opportunity remains unused – growth in labour supply does not translate into growth of employment and economic development, but into increase of unemployment.

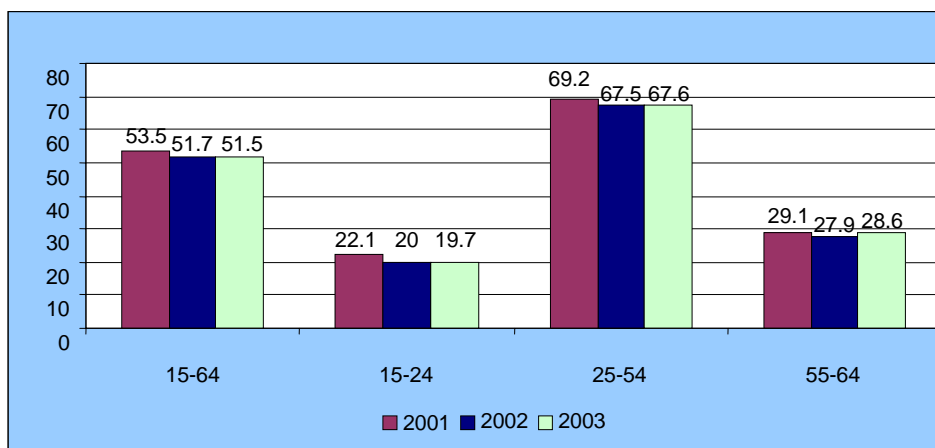
The above observations lead to the conclusion that – despite the fact that the current economic revival may lead to a decrease in unemployment rate and increase of employment – but without the removal of structural barriers an improvement in the labour market will be very small, and not durable.

### **12.3. Structural problems in the labour market**

Unemployment In Poland is characterized by certain permanent and unfavourable features of its structure – regardless of the tendencies manifested in individual years. In 2003, similarly as in the previous years, the features which differentiate the population of employed in Poland were: age, education, location of residence and gender.

#### **Differences in the labour market due to age**

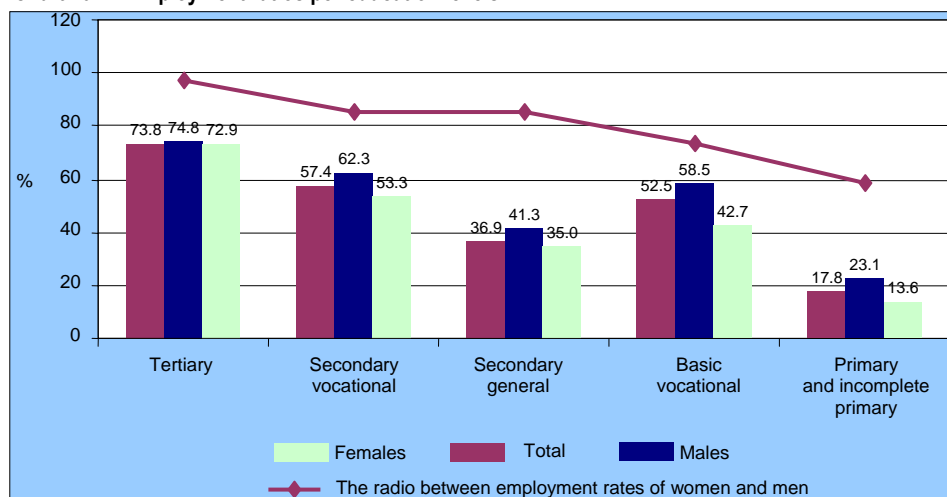
Research confirms that young persons are in particularly difficult situation in the labour market. The most important reasons for low demand for the work of young people include: small professional experience (or complete lack of such), high costs of labour and low level of work discipline of young people. In 2003, the unemployment rate in the group of persons aged 15 to 24 reached the level of 42.9%; and their employment ratio reached 19.7%. Persons aged 50+ are the second group with particularly low economic activity. In 2003, employment rate in the age group 55–64 reached 28.6%. It is not true that the 50 year olds relieve jobs for the young people, when they finish their professional activity. Quite the contrary, in countries where few older persons work (for example due to labour market policies which offer earlier retirement, job incapacity pensions or pre-retirement benefits), the situation of young people is usually very difficult.

**Chart 39. Employment rate per age groups in 2001–2003**

Source: BAEL RESEARCH, CSO.

### Education level as factor determining unemployment

Correlation of the level of education with the situation of individuals in the labour market has been proven many times. The situation of persons with the lowest level of education is particularly bad in Poland. This situation is strongly influenced by the Polish tax and social insurance system. Their construction supports professional de-activation; and makes it very difficult to find employment for persons with the lowest incomes – who mostly have very low level of qualifications. Similarly as in 2002, persons with lower education level and with no vocational training are the most threatened with unemployment. In 2003 the highest level of unemployment (26.3%) and the lowest employment rate (17.8%) were found among persons with primary and incomplete primary education. High rate of unemployment was also found among persons with high school education (22.6%) and vocational education (24%). In 2003, unemployed persons with education on the vocational level or lower constituted 59.6% of all employees (60.9% in 2002). Persons with higher education are the least threatened with unemployment. Among this group, unemployment rate was the lowest and amounted to 7.6%, while their employment rate was the highest, at 73.8%. However, it should be remembered that unemployment among the best educated persons is usually tied to economic situation, and applies primarily to young persons.

**Chart 40. Employment ratios per education levels**

Source: BAEI RESEARCH, CSO.

### Geographical differences in the labour market

One of the important structural problems that Poland faces are deep regional differences in the levels of social and economic development. Analysis of unemployment from the regional perspective shows that high unemployment rate characterizes those provinces which used to be dominated with state farms, and those where industry restructuring processes are underway. The provinces with the highest unemployment rate in 2003 were: the Dolnośląskie (25.6%), Zachodniopomorskie (23.6%) and Warmińsko-Mazurskie (22.2%) Provinces. The lowest unemployment was seen in the Mazowieckie (15.2%), Lubelskie (15.6%) and Opolskie (16%) Provinces.

In recent years, unemployment in rural areas increased. In 2003, the rate of unemployment in rural areas amounted to 19.1% (compared to 17.7% in 2002), and in cities, it reached 20% (21.3% in the previous year). Lower unemployment rate in rural areas can be due to low level of vocational activity in these areas; as well as to concealed unemployment.

### Differences in the labour market due to gender

Women are particularly threatened with being unemployed, although the number of unemployed women is lower than that of men. This is a result of lower

vocational activity of women, which amounted to 58.5% in 2003, compared to 70.4% among men. The results of the BAEL research show that in 2003 women continued to be more threatened with unemployment. Their unemployment rate reached 20.4%, compared to 18.9% among men. The average time of seeking for work by women was 1.4 month longer than in the case of men (16.9 compared to 15.5 month). In 2003, women constituted about 46% of the employed, which means that the gap in employment rates between men and women still amounts to almost 10 percentage points.

## **12.4. Human and cultural capital**

Changes, observed currently in the developed economies, show that the role of the human capital as a development factor is increasingly important. Human capital has become an independent intangible asset, which has an increasing influence on the effective functioning of the economy. In Poland, the most valuable human capital is the relatively young society, whose level of education is improving with every year.

### **Demographic changes**

Demographic processes, aside from economic processes, constitute an important element of shaping the situation in the labour market. In recent years, serious changes in the age structure of the population have been observed. From the demographic standpoint, the population of Poland is still relatively young, compared to other European countries, but the average age increases every year. The number of persons in productive age (women aged 18–59, men 18–64) in 1990–2002 rose by over 1.8 million persons, to the level of 23,789.8 thousand. The share of persons in the productive age in the overall population also rose, by about 5 percentage points and reached about 63% at the end of 2003. It should, however, be remembered that the largest changes occurred among the persons in non-mobile age – aged 44 and more.

From the standpoint of population size, Poland is the 9th largest country in Europe. Its population amounted, at the end of 2003, to 38,191 thousand per-

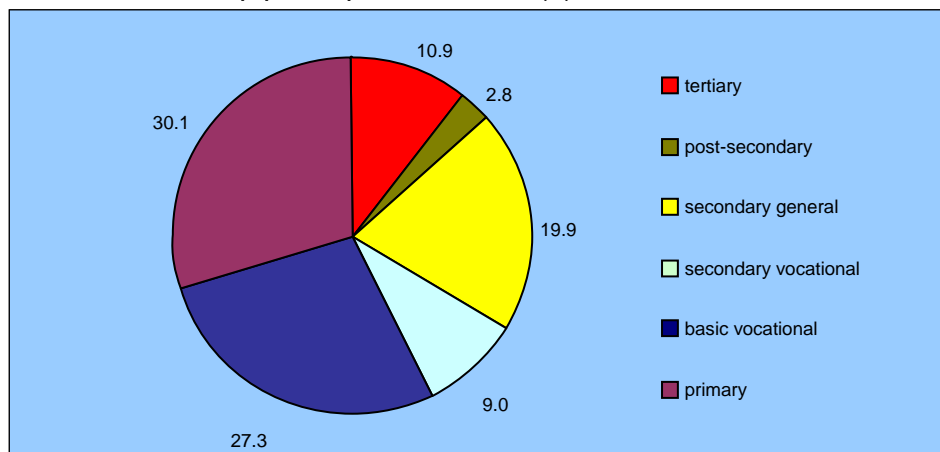


sons. The year 2003 was the fifth subsequent year in which an effective reduction of population was recorded, and the second subsequent one with negative population growth. In 1999–2003, as a result of low population growth and negative balance of foreign migrations, the population of Poland was reduced by about 89 thousand. Population growth was negative and reached  $-0.03\%$  in 1999 and as much as  $-0.08\%$  in 2003, which means that the decrease of population has accelerated.

### **Education**

The Polish society is becoming increasingly better educated with every year. A positive occurrence, observed for the last several years, is the growing interest in higher levels of education (in 2003, the number of college and university students amounted to 1.8 million persons); as well as continuation of education in the form of training or additional studies. As a result, during the last 14 years which separate the National Censuses, we observe a constant growth of the number of persons with secondary education (by 12 percentage points), university education (by 3.7 percentage points); and a decline in the number of persons with primary, incomplete primary and without school education. Positive changes are also observed in the education levels of inhabitants of rural areas. An increase was seen in the number of persons with secondary education (39% in 1988 to almost 56% in 2002); and the number of persons with university education doubled (and reached more than 4%). The percentage of residents of rural areas without any school education was reduced more than two-fold. Despite positive changes, education level in the rural areas is still much lower than in cities.

Despite good education ratios, a large part of graduates encounter problems with finding jobs. The mismatched supply of competencies and demand for work is one of the reasons. To change that situation, it would be necessary to increase quality of education in many schools on one hand; and on the other, to offer the schools an opportunity to more flexibly adapt the scope of education to the needs of the labour market. It would also be necessary to develop a system of training, which allows for acquisition of the skills and qualifications needed to obtain work.

**Chart 41. Structure of population per education levels (%)**

Source: BAEL RESEARCH, CSO.

## 12.5. Salaries and productivity

The average gross monthly salary in the national economy reached PLN 2,201.47 in 2003. It rose by PLN 68.26 as compared to previous year – the nominal increase reached 3.2%. The largest average salary was recorded in the financial services section – PLN 4,020.17 and the lowest in the hotels and restaurants section – PLN 1,756.85.

The growth of salaries in the economy in 2003 was much higher than the inflation level (0.8% during the whole year). This means that the effective increase of salaries did not vary much from the nominal increase. The effective increase of salaries in the economy in 2003 amounted to 2.4%.

**Table 73. Average gross monthly salary in the national economy**

|                | 2002     | 2003     | Dynamics (%)<br>2003/2002<br>(nominal) | Dynamics (%)<br>2003/2003<br>(effective) |
|----------------|----------|----------|--|--|
| Economy        | 2,133.21 | 2,201.47 | 103.2                                  | 102.4                                    |
| - agriculture  | 2,027.20 | 2,090.23 | 103.1                                  | 102.3                                    |
| - industry     | 2,283.29 | 2,350.80 | 103.0                                  | 102.2                                    |
| - construction | 2,084.46 | 2,134.49 | 102.4                                  | 101.6                                    |

Source: Employment and salaries in the economy in 2002 and 2003, CSO.

Given the levels of the monthly average gross salary in individual sections of the economy, we can notice that three sections had average gross salary higher than 120% of the average salary in the economy. These sections are: financial services – 182.6%; public administration and national defense, obligatory social and health insurance – 126.6% and transport, warehousing and communication – 121.2%. In as many as four sections of the economy, the average gross salary was lower than the average salary in the economy. These include: hotels and restaurants – 80%, health protection and social assistance – 82.7%, agriculture – 95% and construction – 97%.

In 2003, average salary in the private sector accounted for 84.6% of salary in the public sector. This proportion became worse by almost 2 percentage points, as compared to 2002. Only in three sections of business activity, the average monthly salary in the private sector was higher than in the public sector.

## **12.6. Social benefits and labour costs**

Labour costs are one of the main factors – but not the decisive one – which determine competitiveness of a given country in international market. Low labour costs support an inflow of foreign capital. This refers in particular to those areas of the economy, which are more labour consuming, and where the labour costs play a decisive role in shaping the costs of production. On the other hand, low labour costs support high level of employment and reduce the level of unregistered employment.

Labour costs refer to hired workers – persons working on the basis of employment contract signed with the employer. These costs are broken into salary costs – gross salaries – and non-salary costs.

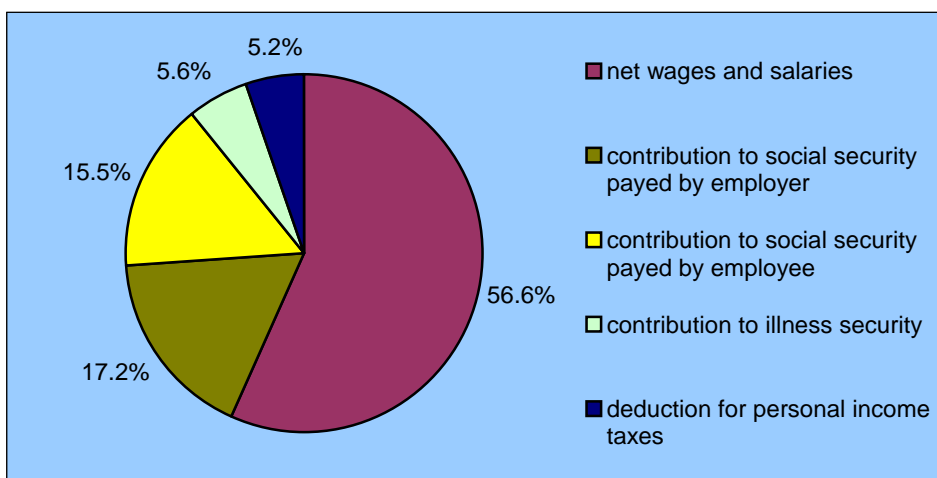
In Poland, the non-salary labour costs include:

- social insurance contributions paid by employers,
- contributions for the Labour Fund and Fund of the Guaranteed Employee Benefits,
- charges for the In-Company Social Benefits Fund (as of 2003, this Fund is obligatory only for entities financed from the state budget, for the other business entities it is fully voluntary),
- expenses incurred by the employer for education of employees.

The salary costs consist of:

- net salary,
- social insurance contributions paid by employees,
- contributions for the National Health Fund and personal income tax.

**Chart 42. Structure of labour costs for the average salary in the economy.**



*Social insurance contributions paid by employers cover also the contributions for the Labour Fund and for the Fund of the Guaranteed Employee Benefits.*

*Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of the CSO data.*

In Poland, the share of taxes and contributions paid by the employer and the employee in the total labour costs (the so-called tax wedge) is high. For an employer who wants to hire an employee for a total salary equal to the average salary in the economy (PLN 2,201.47) total labour costs of will amount to PLN 2,659.16. Of that amount, the employee will receive net salary of only PLN 1,504.21. The tax wedge in this case amounts to 43.4%.

The contributions for obligatory social insurance constitute the largest item of the labour costs (salary and non-salary). They constitute about 32.7% of total labour costs. A low share of the income tax results from the fact that part of contribution for health insurance can be deducted from the income tax advance.

### Changes in the unit labour costs in the economy

When analyzing the structure of labour costs, it is necessary to take into account primarily changes in the effective unit labour costs. The level of these costs depends on three principal factors:

- changes in the average nominal gross monthly salaries,
- changes in the prices of goods and services (CPI) and the prices of sold industrial output,
- changes in the structure of labour costs, taking into account the salary costs (remuneration) and non-salary costs tied to employment.

**Table 74. Unit labour costs in the economy and their effective increase (previous year = 100)**

| Description                               | 2002     | 2003     |
|---|----------|----------|
| Unit labour costs (PLN)                   | 2,930.70 | 3,017.64 |
| Nominal growth of unit labour costs (%)   | 103.9    | 103.0    |
| Effective growth of unit labour costs (%) | 102.0    | 102.2    |

*Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of the CSO data.*

Unit labour costs are the sum of gross salary and the non-salary costs. Aside from social insurance contributions paid by the employer, they also cover costs of education, training and re-orientation of personnel, etc.

In 2003, the increase of unit labour costs in the economy was lower by 0.9 percentage point than in 2002. Given the average annual level of inflation (prices of consumer goods and services), the unit labour costs in industry rose a little in effective terms, as compared to the previous year.

## 12.7. Labour costs and labour productivity

In 2003, as compared to 2002, an increase in labour productivity was recorded in the whole economy. It reached 4.4%. This increase was caused by the strong growth of value added in the economy, while employment decreased. Effective increase of productivity in the sectors of economy, higher than 5% in the course of the year, was seen in industry (8.8%), commerce (5.2%) and transport and warehousing (7%).

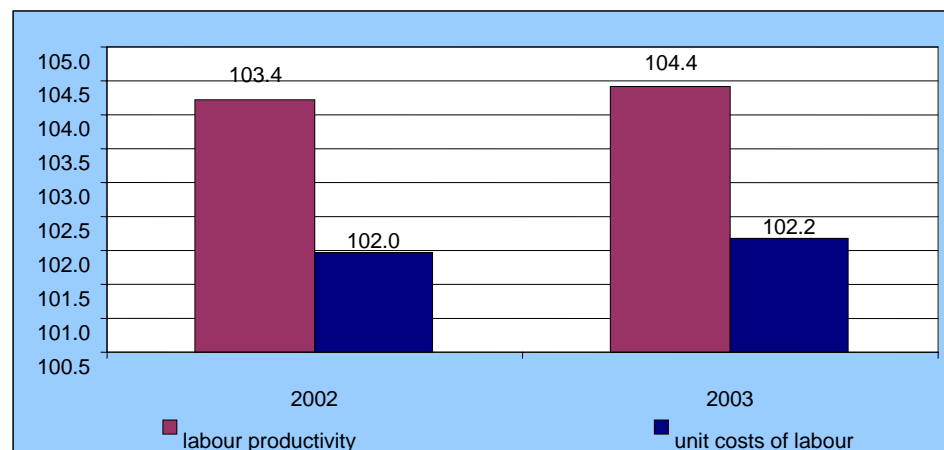
**Table 75. The employed, value added and productivity in the economy in 2002 and 2003**

| Description                                      | 2002      | 2003      |
|--|-----------|-----------|
| the employed (thousand persons, average in year) | 12,728.0  | 12,625.0  |
| gross value added (PLN million)                  | 683,681.0 | 711,998.9 |
| dynamics of the number of workers (a)            | 98.0      | 99.2      |
| dynamics of gross value added (current prices)   | 102.5     | 104.1     |
| dynamics of gross value added (fixed prices) (b) | 101.3     | 103.6     |
| productivity (b/a)                               | 103.4     | 104.4     |

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of the CSO data.

While analyzing the labour costs it is important to evaluate not only the trends in the changes of unit labour costs, but also labour effectiveness. It is desirable for the labour effectiveness to grow quicker than the effective unit labour costs.

In 2003, the increase of productivity in the economy was higher by 2.2 percentage points than the growth of unit labour costs. Compared to 2002, it was an improvement by 0.8 percentage point.

**Chart 43. Labour productivity and unit labour costs in the economy in 2003 (2002 = 100)**

Source: Calculations of the Economic Analyses and Forecasting Department, Ministry of Economy and Labour on the basis of the CSO data.

Compared to the previous year, 2003 was characterized by an increase in employment and unit labour costs. However, unit labour costs rose slower than salaries. This could have been caused by the fact that in 2003 the obligation to

establish the in-company social benefits fund was eliminated, and the rules for calculating premium for accidents insurance were changed. However, comparing the effective increase of salaries and unit labour costs with the increase in labour productivity, certain positive trends can be observed: a significant increase in labour productivity in 2003, compared to 2002; and faster growth of labour productivity than of salaries and unit labour costs.

## Chapter 13

# Public finances and fiscal policy

## 13.1. Public finances and fiscal policy

### 13.1.1. Public finances and fiscal policy

The deteriorating situation of public finances is the second largest – after the high unemployment – problem of the Polish economy.

In 2003, the volume of public debt amounted to 51.6% of the GDP, while budget deficit reached 4.5% GDP. These calculations were made on the basis of methodology which complies with the Public Finance Act. This method differs from the methodology recommended under regulations of the European Union, the so-called ESA95<sup>82</sup>.

#### Box 13. Differences between the Polish and the ESA 95 methodology

There are two fundamental differences between the Polish and the ESA 95 methodology. They apply to rules of accounting and the scope of the public finances sector.

Under the ESA 95, it is recommended to apply the accrual basis, instead of the cash basis applied in Poland. This means that according to the Polish methodology, the liabilities due do not increase the volume of public debt. On the other hand, the debt is increased by payments tied to pledges and guaranties, which is not required under the EU rules.

The second important difference is the scope of the general government sector (deficit and debt of that sector is taken into account for the purpose of evaluating compliance with the nominal convergence criteria defined in Maastricht), and the sector of public finances. These differences apply to three cases:

<sup>82</sup> European System of Integrated Accounts.



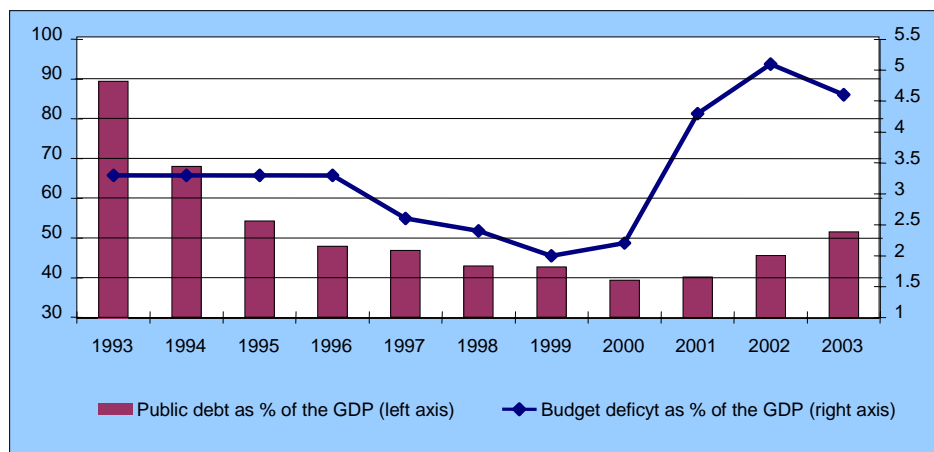
Research and development units and the Agricultural Market Agency – according to the Public Finance Act, these entities were included in the public finances sector; and according to the EU methodology do not belong to it.

Open pension funds – according to the Public Finance Act, they are not included in the general government sector and constitute an element of public finances sector; while according to the EU regulations the open pension funds should be included into the general government sector, but due to the specific nature of the Polish pension reform there are certain factors to exclude the pension funds from that sector. Further bilateral negotiations of that issue are necessary.

The application of the EU methodology instead of the current one leads to reduction of the volume of both deficit and public debt.

Public debt, calculated in that manner, amounted to 45.5% of the GDP in 2003, compared to 41.1% of the GDP in the previous year. In case of deficit, these values amounted to, respectively: 4% and 3.9%.

Chart 44. Volume of the budget deficit and public debt as % of the GDP



Source: Ministry of Finance.

The ratio of budget deficit to the GDP was higher than the limit allowed under the Maastricht convergence criteria (3%). The ratio of public debt to GDP was lower than allowed under these criteria (60%). The Polish Constitution and the

Public Finances Act contain provisions, which regulate the volume of public debt to the GDP. If the thresholds of 50%, 55% and 60% of the GDP are exceeded, this entails the need to apply relevant procedures. In 2003, the first of the caution thresholds was exceeded.

#### Box 14. Caution thresholds and the related procedures

The caution and reform procedures are applied in cases of exceeding the value of public debt, including pledges and guaranties, corresponding to the thresholds of 50%, 55% and 60% of the GDP. Specifically:

- 1) The ratio in year X is larger than 50%, and not larger than 55% of the GDP:
  - a) a limit is introduced on the ratio of state budget deficit to its revenues; this ratio in the draft budget adopted by the Council of Ministers for the year X+2 cannot be larger than in the year X+1,
  - b) the ratio of deficit to revenues, included in the state budget for the next financial year, is the upper limit for reducing the ratio of deficit of each unit of local government to its revenues which can be written in the budget of such unit.
- 2) The ratio in year X is larger than 55%, and not larger than 60% of the GDP:
  - a) the Council of Minister adopts a draft budget law for year X+2, assuming that the upper limit of the deficit is its level which allows for a decline of the ratio of the State Treasury debt – including the projected payments tied to provided pledges and guaranties – to the GDP, compared to the ratio published for year X,
  - b) the deficits contained in the individual budgets of local governments<sup>83</sup> are subject to limitation,
  - c) the Council of Minister presents an improvement programme, which is meant to provide a decline of the ratio of public debt– including the projected payments tied to pledges and guaranties provided by units of the public sector – to the GDP.

<sup>83</sup> As a result of multiplying with the R ratio, calculated in the following manner:  $R = (0.6 - SPD/GDP):0.05$ , where: GDP = gross domestic product; SPD = state public debt, plus the amount of foreseen payments tied to pledges and guaranties granted by entities of that sector.

The ratio in year X is larger or equal to 60% of the GDP:

- a) the draft budget law for year X+2 does not contain the element of state budget deficit, and budgets of local governments are adopted without the element of deficit,
- b) a ban is introduced on any new pledges and guaranties to be granted by entities from the public finance sector,
- c) the Council of Ministers presents to the Parliament an improvement programme, whose basic goal is to develop and implement improvement projects, meant to reduce the ratio of public debt below 60% of the GDP.

It should be noted that the deficit of the public finances sector reached 5.4% of the GDP in 2003. It was by 0.5 percentage point less than a year earlier.

From 2002, a systematic increase of the public debt has been observed, which is a factor negatively influencing the economic situation. The growing debt exerts pressure on the level of interest rates. The effect of uncertainty regarding public finances was particularly visible in the autumn of 2003, when the problem of bad situation in the public finance sector was widely discussed. As the market expected a more restrictive monetary policy, the rates applied on the financial market (the WIBOR rates) were significantly higher from the reference rate. This situation reduces the opportunities for enterprises to acquire money in the market, which in turn causes low level of investment. Private investments are pushed out from the market by public ones, which is a very negative effect. The anxiety about the status of public finances is also the reason for weakening of the Polish currency, which was particularly visible in the autumn of 2003. It should be stressed that a large part of the debt is denominated in foreign currencies (primarily in EUR). The growing debt causes weakening of the currency, which in turn leads to higher repayment costs, which subsequently entails increase of the budget deficit and public debt. In the case of the budget deficit, the most disturbing element is its structural nature, caused by the high proportion of fixed expenses to the GDP.

In 2003, an attempt was made to significantly reduce state expenses, in order to reduce budget deficit and public debt. A Programme to rationalize and reduce the public expenses was presented. The individual decisions contained in that

document are implemented. It should be stressed that the originally presented version of the Programme differs from the implemented one, which may cause the final changes to be insufficient.

**Box 15. The programme of restructuring and reducing public expenditures**

The programme to restructure and rationalize public expenses is meant to introduce changes in the state expenses.

In the case of revenues, changes are planned only in the tax system – they will include an increase of the taxable basis, without increasing tax rates. These changes will include removal of tax reliefs tied to social insurance contributions for some groups of entities, increasing professional and social activity of handicapped persons, as well as a reform of the social insurance system for farmers.

On the expenses side, changes are planned in the three main areas: social expenses, public administration and restructuring of the economy.

The most important area is the first one, as activities in that area not only cause a reduction of public expenses, but also lead to an increase of the employment ratio and increase of tax revenues. Activities in that area would include, primarily: the gradual discontinuation of granting new pre-retirement benefits, until they are completely withdrawn (they would be replaced with bridging pensions and compensations); discontinuation of the valuation of retirement pensions in line with CPI and salary index, introducing valuation based only on the CPI; vocational activation of persons aged 50+; introducing work incentives for persons on pre-retirement and disability benefits and reduction of survivors' pensions and adapting the rules for calculating disability benefits to the rules for calculating retirement pensions under the new pension plan.

In the area of administration, the activities are meant to reduce the costs by cutting down on employment and liquidating some funds and agencies.

In the area of the economy restructuring, the activities would be focused on the restructuring of three threatened sectors: hard coal mining, the State Railways and the health services sector.

### **13.1.2. The state budget**

In 2003, the state budget was not executed fully, both on the revenues and expenses sides. The revenues of the state budget amounted to PLN 152.1 billion, which was 97.7% of the amount provided for under the budget law. Expenses reached 189.1 billion, which constituted 97.3% of the plan. The lower level of execution of expenses, compared to revenues, caused the level of actual budget deficit to be lower than planned under the Budget Act. In 2003, deficit reached PLN 37.0 billion, which constituted 95.6% of the total amount planned for that year.

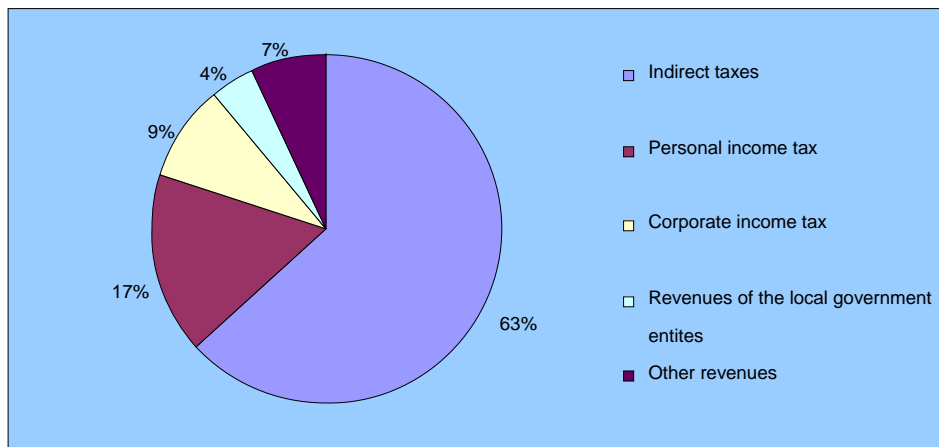
#### **Revenues of the state budget**

In 2003, the volume of the revenues of the state budget amounted to 18.7% of the Gross Domestic Product. In nominal terms, it was higher by 6%, and in effective terms by 5.1% than in 2002.

Revenues of the state budget in 2003 were executed in 97.7% and amounted to PLN 152.1 billion. Execution of tax revenues was lower by 2.3%, non-tax revenues by 0.9%, and foreign revenues by 25% lower than assumed under the Budget Law.

Execution of almost all revenue categories in 2003 was lower than planned. The only exception were the revenues of entities financed from the state budget, which volume was higher than planned by 6.6%.

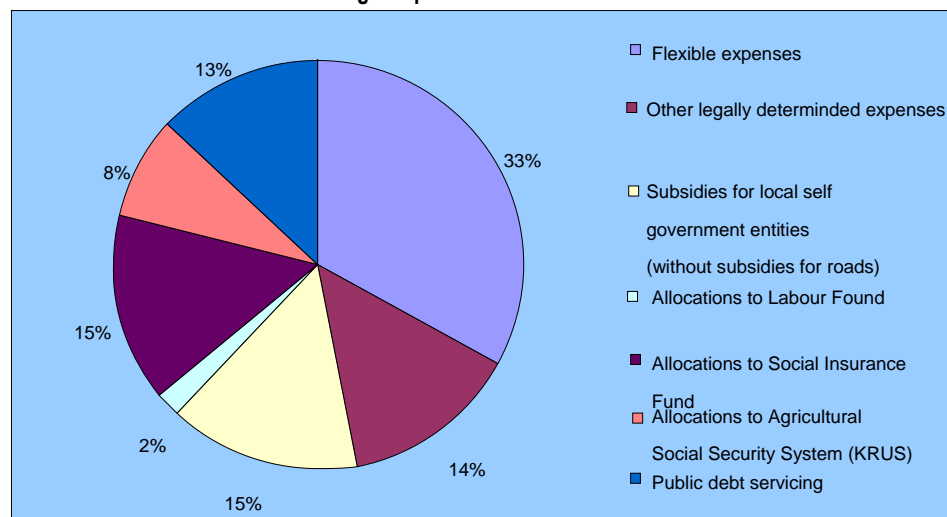
In the case of indirect taxes, revenues were lower by 1.5% than originally planned. Among them, the most important portion were to be the revenues tied to VAT, which turned out to be lower by 2% from their value planned in the Law. This was due primarily to lower consumption, and lower dynamics of prices. The lower than planned revenues on taxes from individuals were caused by a decline in employment (the Budget Law assumed an increase), as well as the move of part of the taxes to revenues of the National Health Fund; as well as the lower than expected revenues from tax on capital gains. In the case of Corporate Income Tax, revenues turned out to be lower by 2% from their value planned in the Budget Law. It is believed that this situation occurred because the entrepreneurs had the opportunity to settle losses from the previous year. It should be noted that in 2003 a significant improvement was seen in the financial situation of enterprises. Gross profit of the enterprise sector rose by 38.9%, while gross loss was reduced by 30.5%.

**Chart 45. Structure of the state budget revenues**

Source: Ministry of Finance.

### Expenses of the state budget

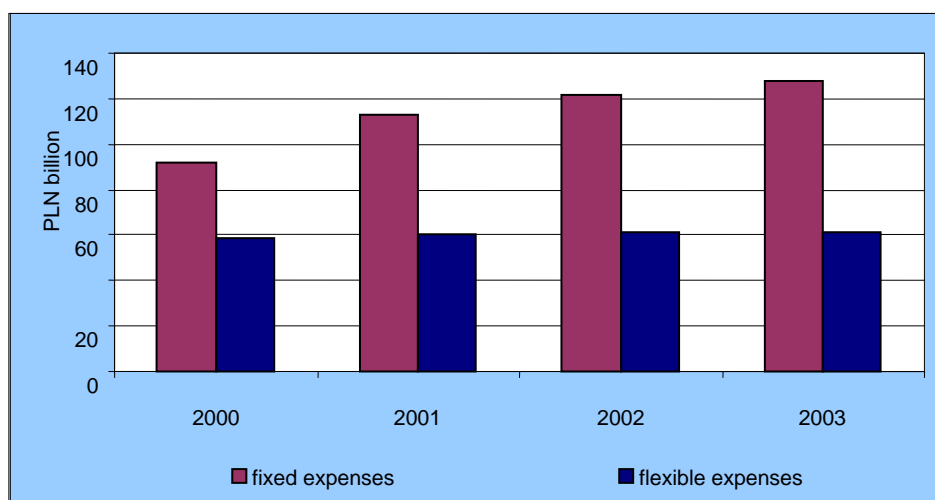
In 2003, the expenses of the state budget amounted to PLN 189.1 billion, and were executed in 97.3%. Expenses of the state budget constituted 23.2% of the GDP. Compared to the previous year, expenses were higher by 3.4% in nominal terms, and by 2.6% in effective terms.

**Chart 46. Structure of the state budget expenses**

Source: Ministry of Finance.

Similarly as in the previous years, the majority of expenses (67.6%) constituted the fixed (determined) expenses – resulting from laws or other, earlier contracted and legally binding obligations. It should be stressed that their share in total expenses has been growing systematically since 1999. In 2002, it reached the level of 66.7%. At the same time, fixed expenses were in 2003 higher by 4.8% in nominal terms than in 2002, and in effective terms, they rose by 4%. The increase of fixed expenses used up 94.6% of the total growth of budget expenses in 2003, compared to 2002.

**Chart 47. The volume of fixed and flexible expenses in 2000–2003**



*Source: Ministry of Finance.*

From among the fixed expenses, reductions were seen in the repayment of public debt, refund of guaranteed bonuses on housing deposits and subsidized interest on housing credits.

Flexible expenses were executed in 97.3%. In nominal terms, they were lower by 0.5%; while in effective terms they were 0.3% higher than in 2002.

Flexible expenses include primarily salaries and other material expenses of state budget entities, subsidies for local government units, for the entities of the public finance sector, for businesses, for entities not included in the public finance sector, and property expenses.

### Deficit of the state budget

In 2003, deficit of the state budget amounted to PLN 37 billion, which constituted 95.6% of the amount written into the Budget Law. Deficit was financed in almost 84% from domestic sources. The remaining 16% was financed from foreign sources. According to the assumptions of the Budget Law, domestic sources were supposed to finance 86.8% of the deficit. It should also be pointed out that in the previous year, foreign sources financed 8.8% of the deficit. In 2003, the volume of financing from foreign sources was higher by 72.9% than a year earlier.

**Table 76. Budget execution in 2002–2003 (PLN million)**

|   | 2002       |           |       | 2003       |           |       |
|---|------------|-----------|-------|------------|-----------|-------|
|   | A          | B         | B : A | A          | B         | B : A |
|   | Budget law | execution | %     | Budget law | execution | %     |
| REVENUES                                | 145,101.6  | 143,538.0 | 98.9  | 155,697.7  | 152,176.0 | 97.7  |
| Taxes                                   |            |           |       | 138,611.6  | 135,155.2 | 97.5  |
| indirect                                | 91,324.5   | 90,119.1  | 98.7  | 96,861.2   | 95,264.4  | 98.4  |
| PIT                                     | 26,540.4   | 24,130.3  | 90.9  | 27,355.7   | 25,678.2  | 93.9  |
| CIT                                     | 13,833.8   | 14,988.2  | 108.3 | 14,394.7   | 14,212.6  | 98.7  |
| Revenues of state owned budget entities | 9,801.9    | 10,732.6  | 109.5 | 10,508.4   | 10,834.3  | 103.1 |
| EXPENSES                                | 185,101.6  | 182,950.0 | 98.8  | 194,431.7  | 189,165.2 | 97.3  |
| debt repayment (domestic and foreign)   | 25,032.0   | 24,048.3  | 96.1  | 27,101.6   | 24,137.4  | 89.1  |
| subsidies for the pension fund          | 15,391.7   | 15,391.2  | 100.0 | 15,013.9   | 15,013.9  | 100.0 |
| subsidies for the social insurance fund | 26,987.9   | 26,987.9  | 100.0 | 28,277.0   | 28,277.0  | 100.0 |
| general subsidies for local authorities | 29,701.6   | 29,701.6  | 100.0 | 31,924.1   | 31,742.9  | 99.4  |
| DEFICIT                                 | -40,000.0  | -39,412.0 | 98.5  | -38,734.0  | -36,989.2 | 95.5  |
| SOURCES OF DEFICIT FINANCING            |            |           |       |            |           |       |
| Treasury bills                          | 5,850.4    | 7,993.6   | 136.6 | 1,886.5    | 6,774.5   | 359.1 |
| Bonds                                   | 26,613.8   | 28,365.0  | 106.6 | 27,443.6   | 27,564.8  | 100.4 |
| Revenues on privatization               | 6,600.0    | 2,178.4   | 33.0  | 7,400.0    | 2,962.9   | 40.0  |

Source: Ministry of Finance.

It should be stressed that in 2003 revenues on privatization were relatively low. They have been executed in 40%. This caused the need to seek alternative



financing sources. The issue of Treasury securities in the domestic market was higher than planned under the Budget Law, by 2.9%. The plan was exceeded the most in the case of Treasury bond sold on the market – by 4.6%.

In 2003, the volume of financing from foreign sources was higher by 16.9% than planned.

## 13.2. Monetary policy

### 13.2.1. The goal of monetary policy in 2003 and its implementation.

The year 2003 was the last year of the Medium-Term Monetary Policy Strategy in 1999–2003. According to that strategy, the goal of monetary policy for 1999–2003 was to have the level of inflation lower than 4% at the end of 2003. In the assumptions of Monetary Policy for 2003, the Monetary Policy Council decided that the goal of monetary policy would be to have inflation on the level of 2.5%, +/- 1 percentage point, at the end of 2003.

Setting the goal on such level is a signal that the Council moved from the phase of reducing inflation to stabilizing it on a low level.

In the Assumptions for Monetary Policy, the Council stressed that one of the most important goals of the Polish economy is to meet the convergence criteria defined in Maastricht, to enable Poland to join the Euro zone as soon as possible.

In December 2003, the annual inflation rate reached 1.7%. It was therefore in line with the goal defined in the Medium-Term Monetary Policy Strategy for 1999–2003; and was below the lower threshold of inflation goal, defined in the monetary policy Strategy for 2003.

**Table 77. The inflation goal and inflation in 2001–2003**

|                | 2001 | 2002   | 2003   |
|----------------|------|--------|--------|
| Inflation goal | 6–8% | 3+/-1% | 3+/-1% |
| Inflation      | 3.6% | 0.8%   | 1.7%   |

*Source: National Bank of Poland.*

The Monetary Policy Council assumed that the increase in prices of food and non-alcoholic beverages would reach about 2%, and the growth rate of controlled prices should range from 3.6% to 4.8%. In 2003, the prices of food and non-alcoholic beverages rose by 2.1%; and the increase of controlled prices was

lower than expected. The first was due to lower grain harvest, compared to 2002, and the decreasing animal production; while the second element can be explained with a lower scope of increases of controlled prices than originally assumed in the Budget Law.

### **13.2.2. The basic conditions of the implementation of the monetary policy in 2003**

In 2003, a gradual economic revival was observed. In the first quarter, economic growth reached 2.3%, and rose to 4.7% in the fourth quarter. Within the course of the year, GDP rose by 3.8%. The forecast regarding economic growth in Poland, contained in the Assumptions, predicted growth of 2–3%. When preparing the assumptions, the Council defined main factors, which were expected to determine the rate of economic growth in 2003. On the one hand, this was relatively weak economic growth among trade partners, and on the other hand, a positive increase in domestic demand. At the same time, the Council put significant pressure on the need to improve situation in public finances. The systematic increase of the State Treasury debt causes a significant increase in the profitability of Treasury securities, and weakening of the Polish currency. In the assumptions for 2003 monetary policy, the Monetary Policy Council stressed that the development of the economic situation in Poland would be largely determined by the situation in the global market – and forecast for that factor is rather hard to predict. The Council stressed the potential increase of petroleum prices, tied to the possibility of conflict in Iraq. This factor would hinder economic growth and lead to higher inflation.

The conditions which determined the situation relevant for monetary policy turned out to be very different from the assumptions. The forecasts of economic growth in countries of the European Union and the United States spoke of increases of 1.8–2.4% and 2.5–3.2%, respectively. In the case of the European Union, they were much higher than reality. In Germany, which is the largest trade partner of Poland, an economic decline was registered (GDP fell by 0.1%). However, the volume of import demand did not diminish despite the unfavorable situation.

This was caused, largely, by higher price competitiveness of Polish goods. In 2003, due to the effective and nominal depreciation of the Polish currency, and increase of labour productivity faster than increase of salaries, the unit labour

costs calculated in Euro fell by 20.2%. Aside from the positive export results, growth of GDP in 2003 was caused also by the higher dynamics of domestic demand, as well as the reversal of the negative trend in accumulation (due to an increase in inventory levels).

It should be stressed that the economic revival did not cause an increase in employment, slowing down a little its decline.

An important factor, which determined the shape of monetary policy in 2003, was the bad situation in the public finance sector. The amount of budget deficit amounted to 4.5% of the GDP, and the volume of public debt reached 51.6% of GDP.

The first half of 2003 was a period of less strident monetary policy. The Monetary Policy Council cut the level of interest rates at each of its six meetings from January to June. However, in the second half of the year none of the meetings ended with a reduction of interest rates. The main factors influencing the policy of the Council in the first half of the year were: the stable low level of inflation (the annual value of CPI was on a low and relatively stable level, while the measures of base inflation have exhibited a downward trend); low inflationary expectations of households; low credit growth rate; salary discipline in enterprises and decline of investment outlays. In the second half of 2003, symptoms of economic revival appeared gradually; the dynamics of sold industrial output rose; research conducted by the CSO suggested an improvement in the areas of production activity and construction; export dynamics was high and financial results of enterprises improved. At the same time, the annual price indexes rose: the Consumer Price Index, the base inflation index and the Producer Price Index. At the end of the year, inflationary expectations have also risen. Despite these factors, combined with the weakening Polish zloty and bad situation of the public finance sector, the Monetary Policy Council decided that the goal of monetary policy, defined in the Strategy, was not threatened.

#### **13.2.3. Instruments for implementation of the monetary policy**

The main instruments used by the National Bank of Poland which are used to determine short term interest rates are open market operations, deposits and credits operations, and the statutory reserve.

Open market operations and the deposits and credits operations are conducted with specific profitability levels, determined by the levels of interest rates.

This means that the level of these rates defines the rates on the interbank market. They in turn influence the interest rates on deposits and credits, which has significant influence on the economy.

### The interest rates

The rates which determine the direction of monetary policy are:

**The reference rate** – this is the prime interest rate, which determines the minimum profitability of open market operations. It also influences the level of market rates with similar maturity. In 2003, the National Bank of Poland shortened the maturity of the basic open market operations to 14 days. This was meant to make the transmission mechanism of monetary policy more effective; provide a more precise influence of the central bank on liquidity level; and adapt to the standards of the European Central Bank.

**Lombard rate** – determines the maximum cost of acquiring money for 1 day from the central bank.

**NBP deposit rate** – defines the price offered by the central bank to commercial banks for placing a one-day deposit with the NBP.

The reductions of interest rates reached from 1 to 2 percentage points, and were lower than in the previous year.

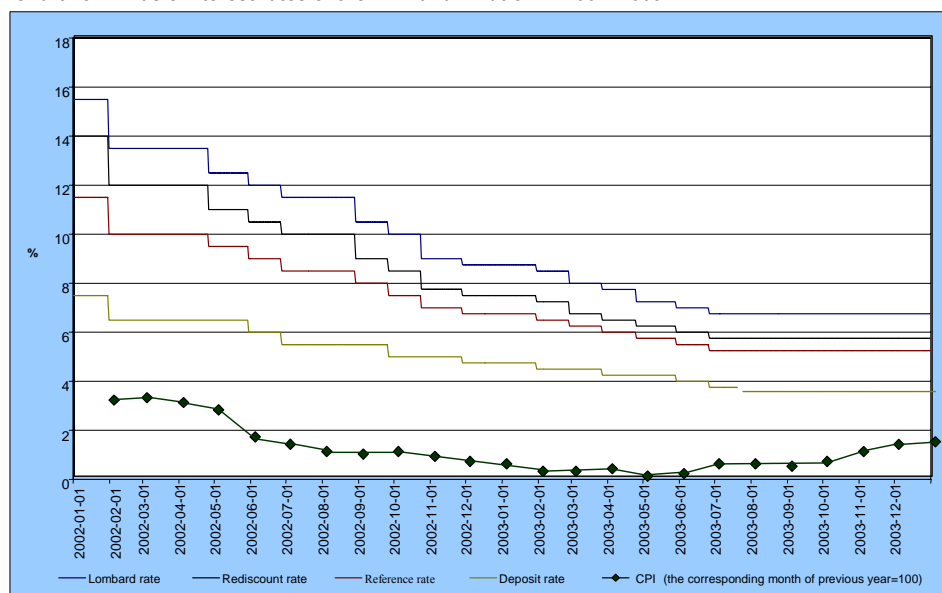
Table 78. Reduction of interest rates of the NBP in 2003

|   | Nominal level of interest rates       |              |                 |              |
|---|---------------------------------------|--------------|-----------------|--------------|
|   | Reference rate (minimum lending rate) | Lombard rate | Rediscount rate | Deposit rate |
| Nominal interest rates in the beginning of 2003 (%) | 6.75                                  | 8.75         | 7.5             | 4.75         |
| Interest rates reductions, in percentage points:    |                                       |              |                 |              |
| 29.01.2003  | 0.25                                  | 0.25         | 0.25            | 0.25         |
| 26.02.2003  | 0.25                                  | 0.5          | 0.5             | -            |
| 26.03.2003  | 0.25                                  | 0.25         | 0.25            | 0.25         |
| 24.04.2003  | 0.25                                  | 0.5          | 0.25            | -            |
| 28.05.2003  | 0.25                                  | 0.25         | 0.25            | 0.25         |
| 25.03.2003  | 0.25                                  | 0.25         | 0.25            | 0.25         |
| Sum of interest rates reductions                    | 1.5                                   | 2            | 1.75            | 1            |
| Nominal interest rates at the end of 2003           | 5.25                                  | 6.75         | 5.75            | 3.75         |

Source: National Bank of Poland.

The reductions of interest rates in 2003 caused the difference between the lombard rate and the deposit rate to be reduced from 4% to 3%. The reference rate was reduced to 5.25% from 6.75%; the rediscount rate fell from 7.5% to 5.75%, the lombard rate from 8.75% to 6.75%, and the deposit rate dropped from 4.75% to 3.75%. Effective rates were also reduced. The reference rate, corrected with the Consumer Price Index, fell in effective terms from 5.9% to 3.51%; and corrected with the PPI, it fell from 4.45% to 1.49%.

**Chart 48. Basic interest rates of the NBP and inflation in 2002–2003**



Source: NBP.

### Open market operations

A situation where the central bank is permanently a net debtor of commercial banks on both short- and long-term operations, is defined as structural excessive liquidity. When the central bank is permanently a net debtor of commercial banks on short-term operations only, this is defined as operational excessive liquidity. In 2003, an excessive liquidity of the banking sector was observed, and thus the open market operations were meant to absorb liquidity.

Open market operations can be divided into three main categories: basic, harmonizing and structural.

The fundamental tool, used in 2003 to reduce operational excessive liquidity, was the issue of cash bonds of the NBP (maturity of these bonds was shortened from 28 to 14 days). The balance of the basic operations of the open market was reduced to PLN 6 billion in 2003, from PLN 7.3 billion in 2002.

In exceptional situations, the NBP can also apply harmonizing operations. They were performed in the form of issue of cash bonds of the NBP, with maturity from 1 to 7 days; or purchase of treasury securities from the banks, or earlier redemption of the cash bonds of the NBP, in situations which required ad-hoc support for the banking sector liquidity.

In 2003, such operations were not applied.

In 2003, the last sale of converted Treasury bonds from the NBP portfolio was held. These operations are of structural nature, and absorb liquidity in a permanent manner. In 2003, the nominal value of converted Treasury bonds offered for sale reached PLN 1.24 billion.

### **Statutory reserve**

The maintenance of statutory reserve by the banks is one of the elements, which alleviates the fluctuations of market interest rates, occurring due to changing liquidity of the banking sector. This reserve is maintained and calculated in PLN, and the deposited funds bear no interest. As of 30 September 2003, the banks are able to reduce the accrued statutory reserve by EUR 500,000. In 2003, an excess of reserves compared to their required level was maintained during almost the whole year – with the exception of December. This excess reached PLN 30 million on the average, during the course of the year.

### **Credit and deposit operations, refinancing of banks**

The credit and deposit operations are meant to supplement the liquidity of the banking sector on a short-term basis. They are also a tool for the banks to invest their free cash for one-day deposits with the central bank. These operations are performed at the banks' initiative.

These operations include the lombard credit and the end of day deposit. The maximum cost of acquiring capital in the market is defined by the level of lombard rate. The average daily debt tied to the lombard credit amounted to PLN 34.2 billion in 2003.

The deposit rate is the lower threshold for the fluctuations of one-day interest rates. The average daily amount of a deposit reached PLN 157.2 billion in 2003.

Refinancing of banks in the form of rediscount for bills of exchange did not play an important role for the management of monetary policy in 2003.

The banks used also technical credit, as an instrument facilitating settlements and management of liquidity within the banking system within the scope of an operations day. This credit is acquired against collateral, to cover a specific payment, and must be repaid on the same day.

#### **13.2.4. Changes in the foreign exchange rates and their influence on economic processes**

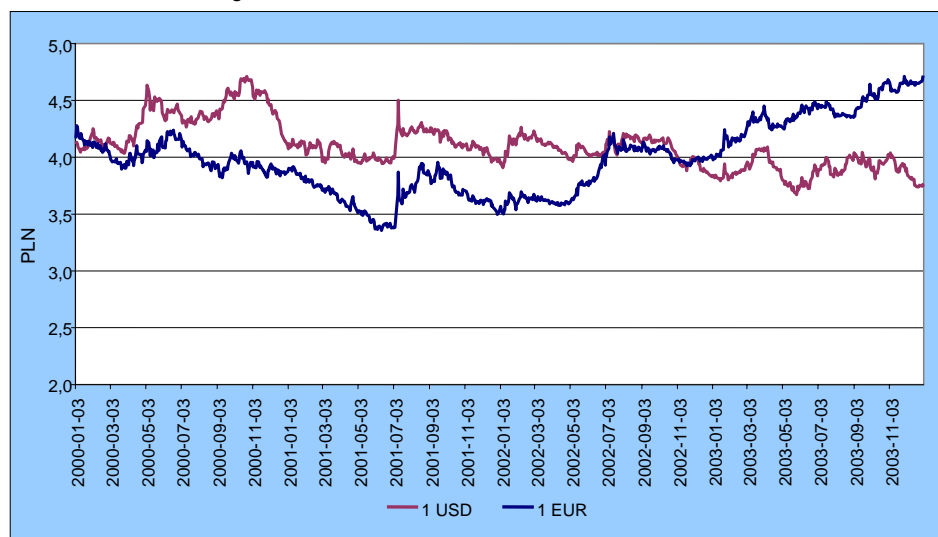
In 2003, the Polish currency weakened strongly in relation to the EUR, but grew stronger in relation to the USD. The average annual exchange rate of the EUR was higher by 14.1% in 2003 from the last year's value, while exchange rate of USD was lower by 5%. The nominal effective exchange rate of PLN dropped by 8.5%, while the effective exchange rate, deflated with the CPI, fell by 7.2%. This means that Polish products were more competitive abroad.

This is confirmed by the very high export dynamics, recorded in 2003. According to data on commodities, export measured in EUR rose by 9.3% in 2003, while import rose by 3.2%, compared to 2002. As a result, the negative trade balance amounted to EUR 12.8 billion, which was by EUR 2.2 billion less than in 2002.

It should be particularly stressed that the positive changes occurred during times when the main Poland's commercial partners were in a period of economic stagnation. This applies in particular to Germany (according to customs statistics, 32.3% of Polish export was sold to Germany), where the GDP fell by 0.1% in 2003, compared to 2002.

In 2003, the net financial results of exporters were much better. In nominal terms, they have more than tripled compared to the previous year (from PLN 3.7 billion to PLN 15.6 billion). The net loss of these entities was also lower than a year ago. It amounted to PLN 9.0 billion, compared to PLN 11.2 billion a year earlier.

Chart 49. The exchange rate in 2000–2003



Source: NBP.

### Transmission of the monetary policy

In December 2003, the inflation rate, measured with the Consumer Price Index, amounted to 1.7%; and measured with the PPI, it reached 3.7%. It should also be noted that as of August 2002, Poland meets the Maastricht convergence criterion regarding the admissible level of inflation. In December 2003, the average annual inflation measured with the HICP<sup>84</sup> index reached 0.7%, compared to 2.1% in countries of the Euro Zone. Thus, we can decide that the current goal of monetary policy is to maintain a low and stable inflation level.

The transmission of monetary policy to the economy was very much influenced by the fiscal policy. In 2003, the profitability curve of the money market moved from negative to positive, which means that the long-term rates offered on the interbank market were higher than short-term ones. In the third quarter, the difference between the rates of the interbank market and the reference rate became larger. This was caused, primarily, by the very bad situation of the public finance sector (discussed in particularly heated manner in the autumn of 2003). When analyzing the transmission of monetary policy, we should stress the fact

<sup>84</sup> Harmonized index of consumer prices.



that despite a more lenient policy in the first half of the year, are still on a relatively high level. The level of market interest rates, measured as the rate of return on Treasury bonds with 10 years maturity, reached 6.76% in December 2003. This was one of the worst results among countries joining the European Union. The higher level of interest rates measured according to that criterion was observed only in Hungary (8.24%). In December 2003, interest rates in countries of the euro zone were on a level not higher than 4.46%.

**Table 79. Average weighted interest rate of credits and deposits at the end of 2002 and 2003 (%)**

|   | December<br>2002 | December<br>2003 | Change |
|---|------------------|------------------|--------|
| PLN deposits of households (up to 1 year maturity)  | 4.6%             | 3.4%             | -1.2%  |
| Term PLN deposits of households                     | 4.2%             | 2.9%             | -1.3%  |
| PLN deposits of enterprises (up to 1 year maturity) | 4.4%             | 3.2%             | -1.2%  |
| Term PLN deposits of enterprises                    | 4.3%             | 3.0%             | -1.3%  |
| Credits of households in PLN, total                 | 14.6%            | 12.1%            | -2.5%  |
| Credits of enterprises in PLN, total                | 8.8%             | 7.2%             | -1.6%  |
| Total credits in PLN                                | 11.6%            | 9.6%             | -2.0%  |
| Foreign currency deposits, up to 1 year maturity    |                  |                  |        |
| EUR   | 1.8%             | 1.1%             | -0.7%  |
| USD   | 0.9%             | 0.5%             | -0.4%  |
| Term foreign currency deposits                      |                  |                  |        |
| EUR   | 1.7%             | 1.1%             | -0.6%  |
| USD   | 0.8%             | 0.4%             | -0.4%  |
| Total foreign currency credits                      |                  |                  |        |
| EUR   | 5.6%             | 4.7%             | -0.9%  |
| USD   | 4.2%             | 3.8%             | -0.4%  |

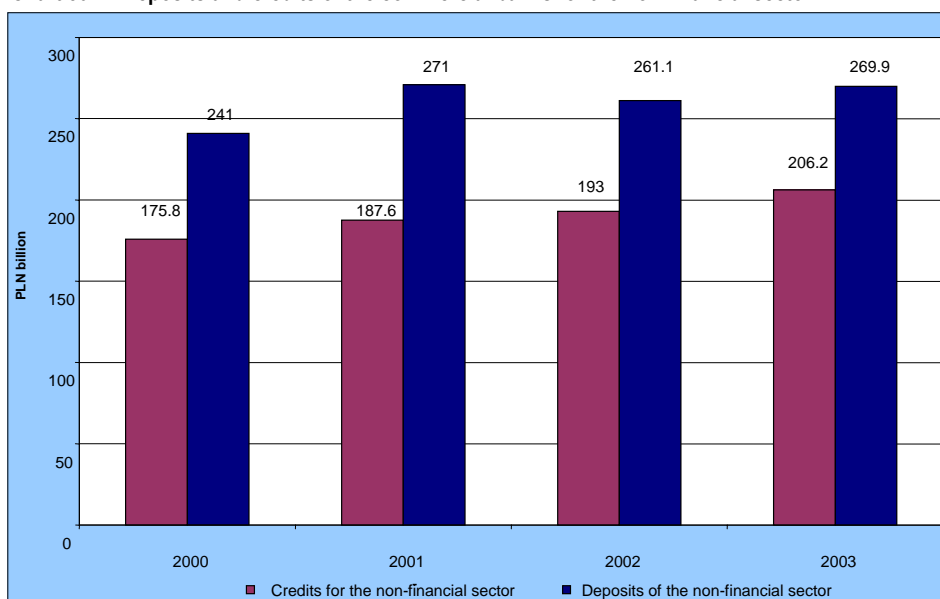
Source: NBP.

In 2003, interest rates in commercial banks fell on both deposits and credits. Interest rates on credits fell faster than on deposits, and a reduction of difference between these values resulted. This was caused, most probably, by the relatively high degree of competition in that sector. It should be noted, however, that the difference between interest rates on deposits and credits is still relatively high.

Interest rate on PLN deposits of households and of enterprises was reduced in a similar scope. In the case of credits, interest rate fell more on PLN credits of households than of enterprises. Similarly as in the previous year, the interest

rates were lower both on deposits and credits denominated in foreign currencies (EUR and USD). This was caused by lower interest rates in countries using these currencies. However, the decrease of the interest rates on credits denominated in foreign currencies was smaller than in the case of credits denominated in domestic currency.

**Chart 50. Deposits and credits of the commercial banks for the non-financial sector**



Source: NBP

In 2003, compared to the previous year, the dynamics of credits granted by commercial banks for the non-financial sector rose significantly. The growth rate reached the level of 40.4%. Credits for households rose much higher than for enterprises. After elimination of reporting errors, the increase in PLN-denominated credits for households amounted to 17.6% in 2003. These changes are caused by the optimistic expectations of households regarding their future financial situation. The additional factor which contributed to this situation was the lower price of credits for households. The reduction of interest rates on credits for enterprises was not so clearly reflected in volume growth. This can be explained with fears of entrepreneurs regarding the future economic conditions, which made them wary of risk, and also not willing to contract debt and engage in investment projects.

The volume of credits denominated in foreign currencies fell in the course of the year. After elimination of reporting errors and the PLN depreciation factor, their volume was smaller by 5.4% compared to the previous year. This fact can be explained by a significant appreciation of the EUR with relation to PLN. The lower interest rates on these credits, in view of further weakening of PLN, does not constitute a sufficient compensation anymore. Entities which already had credits in EUR decided to convert them; and firms which decided to contract credit in the course of the year, more frequently opted for debt denominated in domestic currency.

Deposits of the non-financial sector rose by 3.4% in the course of the year. The source of that growth was the high growth of deposits of enterprises (24.5%). The growth rate of deposits of households was negative and amounted to 2.3%. This data allows for confirmation of the conclusions regarding optimistic expectations of households, and cautious approach of entrepreneurs.

Analyzing the results of interest rate reductions, we should state that they translated primarily into increase of private consumption. They were not clearly reflected in the volume of investment. One of the reasons for such a situation can be unstable situation of the public finance sector. The growing debt of the State Treasury pressures the market interest rates, and causes a push-out effect. However, the situation has another outcome – the Polish currency grows weaker (primarily in relation to the EUR), which makes Polish production more competitive and boosts net exports.

## Chapter 14

# Polish economy on the threshold of the European Union

### 14.1. Harmonisation of business laws

For Poland, the process of European integration commenced in 1991, with the signing of the **European Treaty**, which established an association between the Republic of Poland and the European Community and its Member Countries. This set the basic guidelines for the areas of adaptive measures. **On 16 April 2003, the Accession Treaty** was signed by the 15 Member States of the European Union, and ten newly joining members. At the same time, it became a priority to increase the dynamics of adaptation to the EU requirements. The Council of Ministers adopted, on 29 July 2003, **the Programme for Poland's Preparation to Membership in the European Union**, which included all legislative and non-legislative tasks (regarding primarily institutions) which had to be performed before 1 May 2004.

In 2003, the Ministry of Economy, Labour and Social Policy prepared drafts of 12 legislative acts (half of which applied to business law), and 30 drafts of secondary legislation, meant to adapt the Polish legal system to the legislation of the Communities.

One of the most important tasks was to develop a flexible mechanism that would merge domestic funds with the resources received from the structural funds and the Cohesion Fund into a single system, compatible with the rules of the European Union. The law on the **National Development Plan (NDP), of 20 April 2004**, constitutes a fulfilment of this goal. The plan is a basis for Poland to negotiate the Community Support Framework (a document which determines the directions and amounts of assistance from the structural funds). This document defines the most important structural activities that Poland would start upon becoming member of the EU. The law on the National Development Plan states that NDP provisions must be taken into account during the drawing up of the state budget, draft budgets of the local governments, annual plans of targeted

funds and annual financial plans of other units and entities of the public finance sector during the Plan's subsequent years.

## **14.2. Implementation of the strategic areas for action, defined in the Programme for Poland's Preparation to Membership in the European Union**

The Programme for Poland's Preparation to Membership in the European Union (together with its updates<sup>85</sup>) was meant to identify the tasks related to fulfilment of obligations undertaken in the course of negotiations for the EU membership; strengthening of institutions; execution of tasks tied to the use of funds allocated under pre-accession aid and the financial resources which are to be made available post-accession, as well as monitoring of progress in that respect. These tasks resulted primarily from:

- 1) the National Program of Preparation for Membership in the European Union,
- 2) action plan to strengthen administration and the judicial system,
- 3) Progress Reports of the European Commission, 2002,
- 4) obligations undertaken in the course of negotiations for membership in the EU,
- 5) Conclusions and suggestions from *peer review*.

Aside from tasks not related to legislation, the programme contained a list of draft laws that would adapt Polish legislation to the European Union *acquis*. Monitoring of the status of execution of tasks listed in the document was supervised by the Office of the Committee for European Integration (UKIE), under the works of the Preparations Task Force of the Committee for European Integration, and during the meetings of the Council of Ministers.

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<sup>85</sup> On the basis of Resolution 218/2002 of the Council of Ministers, of 29 October 2002, regarding the tasks that need to be carried out before Poland became a member of the EU, and the system for monitoring their implementation, on 20 November 2002 the Council of Ministers adopted the Programme for Poland's Preparation to Membership in the European Union, which was in force in the fourth quarter of 2002. Updates were made on 29 July 2003 and 15 November 2003 (taking into account the conclusions resulting from Progress Report of the European Commission on the status of Poland's preparation for membership in the EU).

#### **14.2.1. Adapting the law in the area of free movement of goods**

As of 1 May 2004, Poland has a **conformity assessment system for industrial products**, compatible with the EU system.<sup>86</sup> Most products which are subject to the New Approach Directives, must be marked with the CE sign, which confirms compliance with all the provisions of a Directive (or Directives) which apply to a given product - upon conducting assessment of conformity, with a positive result.

Regardless of the legislative measures, implementation of most of the new approach directives was tied to the **authorisation of the certifying entities, testing entities and laboratories** by Ministers relevant for the object of conformity assessment; applications to the European Commission for allocating numbers; and after the date of accession – to the notification of Polish entities in charge of conformity assessment to the Commission and to all Member States. On 30 December 2002, the Polish Committee for Standardisation (PKN) sent to CEN and CENELEC applications for full membership in these organisations. The application was approved on the basis of audit results, and on 1 January 2004 the PKN was granted the status of a fully-fledged member of these organisations.

The general requirements regarding product safety, obligations of producers and distributors regarding the general product safety; and the rules and manner for supervision for providing safety of products introduced into the market are defined in the law of 1 December 2003 on general product safety, which transfers into the Polish legal system the Directive 2001/95/EC of the European Council and the Parliament, of 3 December 2001.

#### **Food safety**

All issues of the domestic food safety are contained in the Food Safety Strategy – a document prepared in February 2002 by the Chief Sanitary Inspectorate, in co-operation with official bodies for food control and with the National Food and Nutrition Institute. Adaptation of Polish legislation to the Community requirements was made through the **amendments to the law of 11 May 2001, on health conditions for food and nutrition**. On its basis:

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<sup>86</sup> The legal and organisational foundations for the system of conformity assessment, including the basis for transposing the new approach directives, have been set forth in the law of 30 August 2002, on the conformity assessment system.

- an obligation was introduced to implement as of 1 May 2004 the HACCP system (*Hazard Analysis and Critical Control Points*) in all enterprises of the food sector which produce and trade food products (with the exception of primary production producers),
- the functioning of the RASFF system (*Rapid Alert System for Food and Feed*) was regulated,
- rules were established for co-operation with the European Food Safety Authority,
- some of the definitions were adapted to the Community laws,
- regulations were introduced on the organisation and execution of food monitoring analyses, in order to evaluate the status of its safety in the country.

During the pre-accession period, a number of actions tied to food safety were undertaken:

- research and development units were nominated that would define and co-ordinate programmes for monitoring food and nutrition<sup>87</sup>;
- the law on materials and products designated for contact with food was amended and updated;
- the Schedule for Implementing Food Safety Strategy was developed, which covers adaptation-related tasks for all bodies performing official food inspection in the areas of legislation, institutional and investment actions meant to improve the national system of food safety; as well as integration of activities of the bodies for official food safety control (the State Sanitary Inspection, Veterinary Inspection and the State Plant Health and Seed Inspection Service), to enable effective analysis and assessment of risk, determination and elimination of threats to consumers, tied to the danger of consuming dangerous foods;
- the National Rapid Alert System for Food and Feed (RASFF) commenced operations,
- an integrated national plan for training in the food safety areas was developed,
- a programme to restructure and develop the laboratories of the bodies of official food inspection was developed,

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<sup>87</sup> Regulation of the Minister of Health of 28 April 2004.

- the process for adapting the laboratories of the State Sanitary Inspection to requirements of the EU was commenced<sup>88</sup>;
- the first laboratory for qualitative and quantitative analysis of genetically modified materials in food (GMO) was opened in Tarnobrzeg. This laboratory, as the only one in the new EU member countries, has received the accreditation certificate<sup>89</sup>.

### **Commercial quality of agricultural and food products**

On 1 January 2003, the **State Inspection of Commercial Quality of Agricultural and Food Products** commenced its operations. It took over the tasks of two control entities: the Inspection of the Purchase and Processing of Agricultural and Food Products, and the Central Standardisation Inspectorate. At the same time, a new regulation<sup>90</sup> was introduced, that defines the same criteria and rules for control with respect to export, import and the domestic market as regards the commercial quality of agricultural and food products. The regulation offers legal grounds for implementing in the Polish legal system a number of regulations, which define the standards for commercial quality of agricultural, and food products, which are set forth in *acquis communautaire*. Since January 2003, the Ministry of Agriculture issued 20 regulations which transpose the provisions of vertical directives and regulations of the EU, defining requirements for commercial quality, including branding, for the individual groups of products.

#### **14.2.2. Adapting the law in the area of free movement of persons – recognition of qualifications**

One of the fundamental rules of the common market of the European Union – next to the free flow of goods, services and capital - is the free movement of persons. **Free movement of persons** – in the economic context – refers to employees, self-employed persons and entrepreneurs.

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<sup>88</sup> This process was financed under the Phare 2001 „Food Safety System” programme, and with the resources of the state budget.

<sup>89</sup> Regulation of the Minister of Health of 26 April 2004 designated that laboratory as the reference laboratory. The European Commission included it in the GMO laboratories network. By 30 June 2004, two more regional GMO laboratories should be set up, in Poznań and in Białystok.

<sup>90</sup> The law of 21 December 2000, on the commercial quality of agricultural and food products.



One of the instruments which serve to eliminate barriers to mobility is the Community **rule of recognising professional qualifications**. According to this rule, a citizen of a Member State of the EU – as well as of other countries of the European Economic Area (that is, Iceland, Lichtenstein and Norway) and Switzerland – who acquired in one of these countries qualifications to perform a given profession or activity, has these qualifications recognised in any other country, under rules defined in the domestic regulations which apply the provisions of Community Directives. This applies, on an equal basis, to persons who obtained their qualifications in Poland and want to perform their professional activities in another country; and to citizens of other Member Countries who want to work in the Polish market.

Competencies of Member States, aside from legislative actions which include implementation of Directive provisions, include a development of appropriate administrative structures that would fulfill the tasks resulting from the Community system for recognising professional qualifications. Since the beginning of 2003, a number of laws were adopted which implement the directives by way of amending current legislation.<sup>91</sup> The law of 12 September 2003, on amendments to the law on the rules for recognition of qualifications to perform regulated professions, obtained in the European Union Member States and on amendmnets to certain laws contains also an amendment to two laws which refer to the general system (which covers other professions and activities), which came into force on 1 May 2004. Secondary legislation was also issued for the above mentioned laws.

As part of non-legislative activities, appropriate bodies were nominated for the purpose of recognising professional qualifications in the particular professions and types of activity. On 1<sup>st</sup> May 2004, national coordinators for directives of the general system, who are responsible for uniform application of the laws, have been appointed at the Ministry of National Education and Sports (for regulated professions) and at the Ministry of Economy and Labour (for business activity). Training is

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<sup>91</sup> The law of 30 October 2003, amending the law on the profession of veterinary doctor and medical and veterinarian chambers; the law of 20 April 2004, amending the Pharmaceutical Law, the law on medical profession and the regulations introducing the Pharmaceutical Law; the law on medical products and the Law on the Office for Registration of Medicinal Products, Medical Devices and Biocides; the law of 20 April 2004 amending the law on the profession of nurse and midwife and some other laws.

continued for persons involved in the recognition of professional qualifications of the general system, under the MATRA project – Strategy for recognition of professional qualifications under the general system (coordinated by the Ministry of National Education and Sports). The Ministry of Health is implementing a PHARE project regarding recognition of qualifications in medical professions.

#### **14.2.3. The rules for state aid during the pre-accession period**

**Public aid** in the European Union may be granted under the condition that the European Commission does not consider it in violation of the EU rules. Under the interim procedure, which commenced on 1 January 2003 and lasted until Poland's full accession to the EU, Poland could present to the European Commission those aid programmes, which it planned to continue after the accession. If the European Commission positively evaluated an aid programme reported under the said procedure, the aid offered under that programme was treated as the so-called existing aid, which would still be permitted after 1 May 2004, without the need for notifying it again. The primary condition for aid programmes to be approved by the European Commission under the interim procedure was that they had to be in the form of legislation<sup>92</sup>.

Until 30 April 2004, under the interim procedure, 45 aid programmes and 12 cases of providing individual aid were sent to the European Commission. At the same time, the Office for Competition and Consumers Protection (UOKiK) was provided with 17 draft *de minimis* programmes. As these do not have to be notified to the European Commission, they were not sent to the EC under the interim procedure.

The detailed rules and conditions for state aid in the pre-accession period were regulated by the law of 27 July 2002, on the conditions for admissibility and supervision of public aid for entrepreneurs. As of 31 May 2004, the law on procedure in cases regarding public aid came into force.

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<sup>92</sup> Compliance with that condition of the European Commission was effected by the adoption, on 19 September 2003, of the law on the conditions for admissibility and supervision of public aid for entrepreneurs.

**Box 16. The law on procedure in cases regarding public aid came into force.**

The law defines rules for procedure in matters tied to state aid, which meets the conditions defined in art. 73, articles 86–89 and article 296 of the Treaty establishing the European Community, including:

- 1) procedure for preparing for notification proposals for aid programmes, proposals for individual aid and proposals for individual aid designated for restructuring,
- 2) the rules for co-operation between the President of the Office for Competition and Consumers Protection with entities developing aid programmes, entities which grant aid, entities which apply for aid and beneficiaries of public aid;
- 3) the rules for representing the Republic of Poland in cases at the European Court of Justice and the Court of First Instance, tied to public aid issues;
- 4) the rules and manner for refund of public aid;
- 5) the rules for monitoring of public aid.

**Special Economic Zones (SEZ)**

In December 2002, Poland completed negotiations with the European Union, regarding adaptation to EU system of the rules for granting public aid to entrepreneurs operating in the Special Economic Zones, on the basis of permits issued until the end of 2000.

**Box 17. Conditions for engaging in business activity within the SEZ:<sup>93</sup>**

The conditions for managing business activity within the SEZ, negotiated and recorded in the Treaty, are as follows:

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<sup>93</sup> These conditions have also been confirmed in the law of 2 October 2003, amending the law on Special Economic Zones and other laws. The draft law states that the rules negotiated for entrepreneurs who hold permits issued from 1995 to 2000 would become effective on the date when Poland joins the EU. On its, the Council of Minister adopted on 30 March 2004 the secondary provisions, which changed regulations regarding the establishment of all 14 Special Economic Zones, which function currently. The provisions of the regulations adopted the conditions of the Zones' functioning to conditions set forth in the Treaty.

- 1) a transition period was established – maintenance of current rights – for small enterprises until the end of 2011, and for medium-sized ones until the end of 2010;
- 2) for large entrepreneurs who received permits by the end of 1999, the maximum volume of public aid amounts to 75% of the project costs; and in case of permits issued in 2000 – 50%; for enterprises from the motor vehicle industry, maximum public aid amounts to 30% of total project costs;
- 3) the start date from which aid for large enterprises and enterprises from the motor vehicle sector is calculated, is set at 1 January 2001;
- 4) decision was made on reduction of investment projects which can be covered by public aid – in the case of large enterprises and enterprises from the motor vehicle sector – to expenses incurred from the date of receiving the permit until the end of 2006.

#### 14.2.4. Adaptation in the area of energy and industrial policy

##### Adaptation in the area of energy

##### *1. Development of the programme for building a competitive gas market*

The gas sector in Poland is currently in the transformation period. The adaptation of the structure of the Polish gas market to make it function effectively within the European Union is supported by the document **Programme for introducing a competitive gas market in Poland**, and the schedule for its implementation, adopted by the Council of Ministers on 27 April 2004. This programme supports implementation of Poland's energy policy, which assumes promotion of competition and adaptation of the Polish gas market to effective functioning within the European Union single market.

A necessary condition for introducing competitive mechanisms is the effective implementation of the rule for free third party access to the gas network. As of 1 July 2004, all buyers who are not individual households have the opportunity to use the gas transfer services, and as of 1 July 2007, this will apply to all recipients. A process of legal, organisational and decision-making separation of the transport and distribution from the trade in gas fuels shall be conducted. Cur-

rently the process of separating an operator of the transfer system from the Polish Oil and Gas Company (PGNiG S.A.) is underway. That operator would be independent from other gas-related activities. Similar actions would be undertaken with relation to operators of distribution systems. A number of activities shall be undertaken to adapt the gas infrastructure to the provision of third party access (TPA) services.

## *II. Execution of accession obligations – long-term contracts in the power sector*

The basis for the activity of government administration bodies with respect to restructuring of the power sector and the introduction of a competitive electricity market are the following documents: **Evaluation of implementation and amendment of the assumptions of Poland's energy policy until 2020** (adopted by the Council of Ministers on 2 April 2002); and the document developed on the basis of its provisions – an **update of the programme for the introduction of a competitive electric energy market in Poland and the „Programme for implementing the ownership policy of the State Treasury Minister towards the energy sector”**. Both documents have been approved by the Council of Ministers at its meeting on 28 January 2003.

The most important task is the restructuring of long-term contracts (known as KDT), concluded between the Polish Power Grid Company (PSE S.A.) and the producers of electric energy in 1994–2001. The need to restructure the KDTs results from the fact that currently they cover about 60% of all electric energy sold in Poland, excluding it from free trade. The price determined in these contracts is higher than the market rate. As a result, the prices for end users are higher than those warranted by the market.

A basis for the current work is the Programme for restructuring the long-term contracts (KDTs) for the purchase of power and electricity, signed between PSE S.A. and producers of electric energy. That programme was adopted by the Council of Ministers on 29<sup>th</sup> July 2003. Under the adopted programme for restructuring of the KDTs (termination of the contracts and securitisation of liabilities), the long-term contracts would be terminated by force of the law (on the basis of a special legislation). In return for the terminated KDTs, the producers would be

offered compensation. Solutions contained in the programme shall be implemented by force of laws on the rules for compensating the costs of terminating the long-term contracts for the sale of power and electric energy. The draft law was sent to the Polish Parliament on 6 February 2004. Further work on this law has been conditioned upon the outcome of negotiations with the European Commission, regarding the scope of public aid, which have been commenced in June 2004.

### *III. Promotion of electric energy produced from renewable sources*

The law of 2 April 2004, amending the Energy Law and the Environment Protection Law, fully adapts Polish legislation to the requirements of Directive 2001/77/EC of the European Council and the Parliament of 27 September 2001, **on the promotion of electric energy generated from renewable sources in the internal market of electricity.**

### *IV. Stocks of liquid fuels*

Under the accession negotiations, Poland was granted the right to temporarily suspend the application of art. 1 of the Directive 68/414/EC, which imposes on the member countries the obligation to keep **stock of liquid fuels** equal to a ninety days volume of consumption of these fuels in the domestic market. A transition period was also agreed for the building up of stocks to the required level – until the end of 2008.<sup>94</sup> Supervision of the schedule was entrusted to the State Agency for Material Reserves. Reports on the levels of liquid fuels stocks are provided to the European Commission on a monthly basis.

### *V. Restructuring of the oil sector*

The fundamental document which sets forth the goals and rules for restructuring and privatisation of the oil sector in Poland is the „**Strategy for the oil sector in Poland**”, adopted by the Council of Ministers on 22 September 2002.

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<sup>94</sup> The execution of this task is done on the basis of the law of 6 September 2001, amending the law on the state reserves and statutory stocks of fuels; and on the basis of regulation of the Minister of Economy of 14 June 2002 regarding the schedule for development of stocks of liquid fuels.

The main goal for the restructuring and privatisation of the oil sector is to strengthen the market position of entities operating in this sector; to provide them conditions for durable and sustainable development; and to guarantee the country's energy safety, together with protection of consumers' interests.

*V. Actions tied to protection of the natural environment in the power sector.*

Poland's accession to the EU entails the need to comply with a number of requirements posed for the Polish power sector, tied to its adaptation to European standards regarding protection of natural environment. It will be necessary to comply with stricter standards regarding emissions of such pollutants as sulfur dioxide, nitrogen oxides and dusts<sup>95</sup>. The stricter emission standards will be binding for Polish enterprises as from 2008. As a result of accession negotiations, approval for a number of transition periods was obtained.

Adaptation is also necessary in the following areas:

- reduction of emission of greenhouse gases to the atmosphere – in line with the Kyoto Protocol, ratified by Poland in 2002, to the United Nations Framework Convention on Climate Change,
- quality parameters for fuels used in vehicle transport to the requirements defined in Community directives<sup>96</sup>,
- protection of air (reduction of sulfur content in light and heavy heating oils)<sup>97</sup>.

*VI. Activities tied to energy effectiveness of equipment*

Adaptation of domestic regulations on energy effectiveness requirements, resulting from regulations of the European Union, was implemented gradually – in

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<sup>95</sup> According to the provisions contained in the Directive 2001/80/EC of the European Council and the Parliament, of 23 October 2001, on reducing the emissions of certain pollutants from large fuel-burning sources.

<sup>96</sup> Requirements regarding engine petrol and engine oils were transposed to the Polish legal system, in compliance with the directive 98/70/CE of the European Council and the Parliament, specifying the quality of petrol and diesel oil, and amending the Council Directive no. 93/12/CE, and the Directive 2003/17/CE of the European Council and the Parliament which amended that directive. As of 2005, sulphur-free engine oils should be gradually introduced into the Polish market.

<sup>97</sup> The decisions contained in Council Directive 99/32/CE were implemented in the regulation of the Minister of Economy of 17 December 2002 regarding the detailed quality requirements for certain liquid fuels.

line with the introduction or update of directives for the individual groups of equipment<sup>98</sup>.

### *VII. Adapting hard coal mining sector to functioning within the European Union*

Member countries of the European Union are provided freedom of actions in the area of restructuring their coal industries. This results from the need to provide security in the energy sector. Thus, it is necessary to maintain the production of coal with state support, at the same time taking into account the need to continue the process of restructuring the hard coal mining sector. That reform is necessary so that Community coal can be competitive in relation to imported coal. Procedures required when applying for state aid for the coal industry are defined in the Council Regulation 1407/2002.

According to the Council Regulation EC/1407/2002 of 23 July 2002, it is necessary to develop plans for access to coal reserves, and plans for closing down production units.

#### **Adaptation in the area of industrial policy**

**Poland** did not apply for transition periods, and **fully accepted *acquis communautaire* referring to industrial policy already during the accession negotiations.** It does not require transfer into the domestic legislative system, as it contains recommendations regarding policy of competition in industry, which are not binding for member countries. These recommendations are defined both on the horizontal level, and specifically for the (selected) sectors.

The condition to close negotiations in the area „Industrial policy” was presentation of assumptions for Poland's industrial policy. These assumptions have

<sup>98</sup> Regulation of Minister of Economy, Labour and Social Policy of 2 April 2003 was issued, regarding the requirements of energy effectiveness, which transposes into the Polish legal system the provisions contained in the following Directives of the European Union: 92/75/EEC, 94/2/EC, 95/12/EC, 95/13/EC, 96/60/EC, 96/89/EC, 97/17/EC, 98/11/EC, 2000/55/EC, 2002/31/EC, 2002/40/EC. The regulation sets forth energy effectiveness requirements and sample labels for equipment covered by the said directives. In 2003, the EU directive 96/57/CE of September 1996 was transposed into the Polish law, regarding the requirements for energy effectiveness of fridges, freezers and combined electric household equipment. Implementation of that directive was made with the Regulation of the Minister of Economy, Labour and Social Policy of 2 December 2003, regarding fundamental requirements regarding energy consumption by freezing equipment.



been defined in the document **Industrial policy guidelines for 1999–2002** (the primary strategic goal of that policy was the increase of international competitiveness of Polish industry).

A threat for realisation of the goals of the Lisbon Strategy, adopted by the European Council in 2000, caused industrial policy to be widely discussed within the EU again, since 2002. This is reflected in the communiqué of the European Commission of 11 December 2002, „**Industrial policy in enlarged Europe**”.

The basis for Polish industrial policy in 2003 and 2004 are the decisions contained in the document adopted on 29 January 2002, the government’s economic strategy „Enterprise – Development – Work” which covers tasks until 2005; and the document adopted by the Council of Ministers on 1 July 2003, **the plan for growth promoting activities in 2003–2004 („Enterprise – Development – Work II”)**.

The goals and measures contained in the Plan take into account, to a large extent, the priorities of the Lisbon Strategy. The development initiatives are an expression of Poland’s active approach to the challenges tied to implementation of the Strategy and EU membership, and of an attempt to profit from the related opportunities, taking into account the situation of our country.

Industrial policy, targeted at increasing the competitiveness of Polish enterprises, is executed through:

- 1) creating conditions for operations that would support the development of enterprise and management of activity by all entities, in line with the EU laws,
- 2) selective intervention in specific sectors and areas of activity, through horizontal and sector-oriented aid of the state.

Industrial policy – especially in its broad understanding – is executed not only with all-encompassing programmes but primarily by programmes focusing on the individual areas and aspects of that policy.

#### **14.2.5. Adaptive actions meant to support competitiveness of the sector of small and medium-sized enterprises (SMEs).**

In 2003, another programme addressed at small and medium-sized enterprises was adopted – the document „**Government policy guidelines for small and medium-sized enterprises for 2003–2006**”. The support of projects which

promote the development of enterprises is the most important area of this document.

In 2003, small and medium-sized entrepreneurs could benefit from **free information and advisory services**, regarding basic issues tied to business activity, financed with the state budget resources and offered at the Consulting and Advisory Centers. Entrepreneurs could also obtain support in the form of co-financing of the costs of advisory and/ or training services.

Entrepreneurs could also apply for **loans for innovative projects and activities**, including: implementation of results of research & development works; purchase of domestic or foreign licenses; purchase of machinery, equipment and installations and their assembly; the construction, enlargement or modernisation of buildings and installations needed to introduce the innovations.

Support offered to entrepreneurs is executed through the Polish Agency for Enterprise Development (PAED), the network of the National SME Services Network (KSU) which is supervised by the Agency, as well as through the system of Regional Financing Institutions, which cooperate with the Agency.

In 2003, the first edition of an open competition was held, for financing the participation of organization of small and medium-sized entrepreneurs in the work of international and sectoral groups. The direct goal of that project was to promote the Polish achievements and experiences abroad, and to provide a stronger and more effective representation of the interests of small and medium-sized enterprises in the international forums. Support was provided to 14 institutions – associations of small and medium-sized enterprises. In 2004, another such competition was organized, and support was granted to 40 organizations.

In June 2003, the Council of Ministers adopted a report **Enterprise in Poland**<sup>99</sup>. This report presents – aside from the macroeconomic situation and characteristic of enterprises – the most important problems tied to the functioning of enterprises. The report contains also recommendations for further actions, which are necessary to foster development of the economy and enterprises. They are reflected in the plan for growth promoting activities in 2003–2004 „Enterprise – Development – Work II” (it constitutes the continuation and supplement

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<sup>99</sup> On 6 July 2004, the Council of Ministers approved the second edition of the report.

of the Government's economic strategy, „Enterprise – Development – Work”). The basic condition for accelerating economic growth is the stimulation of enterprise, and in particular, reduction of barriers to enterprise development.

As a result of implementation of that document, the procedure for registration of new businesses was improved and simplified. A business person registering a new business can at the same time file application for entry in the register of entities of the national economy, maintained by the relevant statistical office; and the identification or update registration with the tax authorities. A new law on freedom of business activity was adopted in 2004. Its regulations significantly broaden the area of economic freedom and eliminate many of the existing administrative burdens.

In 2003, implementation of the Government programme to develop the system of loan and loan guarantee funds for small and medium-sized enterprises in 2002–2006, called „**Capital for the entrepreneurial**”. The purpose of the programme is to facilitate entrepreneurs' access to external financing sources for their activity. The goal of the programme is to build, over the next four years, a network consisting of about 100 local and 16 regional loan guarantee funds, for small and medium-sized enterprises; and about 100 local and 16 regional loan funds, for small companies. The loan and loan guarantee funds receive capital support every year. At the end of 2003, there had been 50 loan guarantee funds and 76 institutions, which managed loan funds operating in Poland.

In September 2003, the second report was prepared on the implementation of the „**European Charter for Small Enterprises**”. The guidelines of that Charter have been adopted by Poland. This report presents the most important activities, undertaken within the last year to implement the individual provisions of the Charter.

In March 2004, in order to facilitate entrepreneurs the commencement and execution of investment projects, the government adopted the „**Investment report: the construction process – investment barriers and proposals for improvement measures**”. This report presents a general characteristic of the investment process on the basis of opinions and experiences of investors and the barriers encountered by investors at the individual project stages. On that basis, it proposes certain actions for improving the construction investment process, both of legislative and organisational nature. The task force working on facilitating the investment construction process has been appointed by the Minister of

Infrastructure and the Minister of Economy and Labour. Representatives of various circles participate in its works – organisations of entrepreneurs and construction investors, local authorities, trade and craft organisations, and associations tied to the construction sector; and the task force works on finding ways to overcome investment barriers.

#### **14.2.6. Other adaptive activities**

As part of adaptation to membership in the European Union, it became necessary to develop a new concept for the management of the job market and for offering services for job seekers. That concept had to comply with the EU regulations. On 20 April 2004, **the law on promotion of employment and institutions of the labour market** was adopted. The new model for managing services of the labour market is to link three areas: stimulation of employment growth and the development of human resources, prevention of unemployment and professional activation of persons who are jobless, alleviation of the negative results of unemployment and preventing exclusion from the society. The new solutions are meant to improve the actions of social support institutions for persons needing help, increase the effectiveness of assistance for the job seekers, and thus contribute to increasing the flexibility of the labour market. Implementation of the new solutions is one of the conditions for effective use of the resources of the European Social Fund.

Another adaptation-related law, of 20 April 2004, amending the **Law on Measures**, introduced the clause of mutual recognition. It is meant to guarantee that this clause would be applied to measuring devices and equipment covered by the provisions of that law. Also, it has been decided that as of the day when Poland becomes full member of the European Union, the procedure of metrology control will comply with the procedure for the conformity assessment. The amendment provides for an opportunity to establish a special measure to be designated for execution of metrology-related tasks, that would guarantee the necessary development of the domestic system of measures and compliance with requirements of the EU laws; and would also increase the competitiveness of Polish offices of measures in the EU market.

The need to amend the current **law on tourist services** was a result of experiences gained in the course of more than four years of the law's functioning.

The main purpose of the amendment is to remove the provisions which lead to problems with interpretation; to remove other doubts which arose from application of the law and also to introduce the new regulations, proposed by entrepreneurs, that would facilitate business activity in the sector of tourist services. The amendment introduces also new regulations, which facilitate its implementation by administration bodies – taking into account the primary goal of the law, that is, protection of interests of the consumers of tourist services. It still does not contain regulations that would settle the issue of tourist vouchers.

An amendment to the **law on explosives** designated for civilian use has been also prepared. That amendment adapts Polish legislation to the provisions of the New Approach Directive 93/15/EC of 5 April 1993.

In the area of business law, many secondary regulations of adaptive nature have been issued.

### **14.3. Compliance with the criteria of the Maastricht Treaty – participation in the Economic and Monetary Union**

Poland, declaring in its negotiation position readiness to join the European Union at the end of 2002, confirmed also its intention to join the Economic and Currency Union (ECU) and its readiness to replace PLN with the European currency – the EUR. The provisions of the Treaty do not impose on Member States the obligation to participate in the common currency. Despite this, Member States are obliged to accept and share the main EU goals, which include the creation of a fully unified common market, and the common currency. Participation in the Economic and Monetary Union depends on meeting the convergence criteria, which are defined in the Maastricht Treaty.

A formal decision regarding Poland's accession to the ECU shall be made by the Economic and Financial Affairs Council, on the basis of conclusions contained in the Convergence Reports. Convergence Reports are prepared by the European Commission and the European Central Bank every two years, at the request of Member Countries which do not participate in the Euro zone. Poland will be able to request a report after it participates in ERM II for two years.

**Box 18. Criteria for nominal convergence**

The Maastricht Treaty defines five criteria, which are the condition to participate in the ECU, which can be broken into two groups:

**1) The fiscal criteria:**

- **Budget deficit:** the share of planned or actual government deficit should not exceed 3% of the Gross Domestic Product, in the year preceding the analysis regarding the compliance with conditions;
- **Public debt:** in the year preceding the analysis, the share of public debt in the Gross Domestic Product should not exceed 60%;

**2) Monetary criteria:**

- **Stability of prices:** the average inflation rate in the year preceding the analysis regarding the compliance with convergence criteria should not be higher by more than 1.5 percentage point than inflation in three best performing EU member countries in terms of price stability;
- **Interest rates:** the average long-term nominal interest rate in the year preceding the analysis regarding the compliance with convergence criteria should not be higher by more than 2 percentage points than the average of such interest rates in three best performing EU member countries in terms of price stability;<sup>100</sup>
- **Foreign exchange rate:** a country aspiring to the ECU should participate for a period of at least two years in the Exchange Rate Mechanism II (ERM II). During that period, the exchange rate of the national currency should fall within the so-called normal spectrum of fluctuations with respect to the central parity, which amounts to +/- 15%. During that time, no serious tension in the foreign currency market should appear.

<sup>100</sup> At the moment of introducing the Euro (1 January 1999), the reference value is the level of inflation and interest rates of the Euro zone – replacing the three best countries with the lowest inflation rate.

### Evaluation of the nominal convergence of Poland

#### 1) Fiscal criteria:

- **Budget deficit:** Poland exceeds the allowable ratio for the deficit in the public finance sector. Deficit, measured according to the method used by the European Commission (ESA 95) amounted to 4.1% of the GDP<sup>101</sup> in 2003. The Council of Ministers adopted, on 8 October 2003, The Programme on Restructuring and Reducing the Public Expenditures. Reduction of deficit should occur starting from 2005<sup>102</sup>.
- **Public debt:** In this respect, Poland complies with the conditions of the Maastricht Treaty. The amount of public debt in 2003 reached 45.3% of GDP, measured according to ESA 95 method.<sup>103</sup> The debt of the public sector in 2004, according to the forecast contained in the Justification to the 2004 Budgetary Law, is supposed to reach 47.6% of the GDP, and should stabilise at the level of 51.3–51.4% of the GDP in 2005–2006.<sup>104</sup>

#### 2) Monetary criteria:

- **Stability of prices:** In this respect, Poland complies with the conditions of the Maastricht Treaty. For the first four months of 2003, inflation has shown a downward trend: from 0.8% in December 2002 it dropped to its lowest ever level, 0.3% in April 2003. In the subsequent months, it rose to reach 1.7% as annual average, in December 2003.<sup>105</sup> Poland complies with the inflation criterion since August 2002.
- **Interest rates:** In this respect, Poland complies with the conditions of the Maastricht Treaty. So far, the reference value that would be the basis to evaluate compliance with that criterion has not been set. Unofficially, the reference value is compared to profitability of 10 year bonds and

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<sup>101</sup> The Convergence Programme - adopted by the Council of Ministers on 30 April 2004.

<sup>102</sup> According to the forecast contained in the Justification to the 2004 Budgetary Law, the deficit of the public finance sector should reach 5.7% of the GDP in 2004, according to the ESA methodology.

<sup>103</sup> The Convergence Programme - adopted by the Council of Ministers on 30 April 2004.

<sup>104</sup> „Report on the benefits and costs of Poland's accession to the Euro zone” – National Bank of Poland, Warsaw, February 2004. It is worth noting that according to the Polish methodology, the deficit of the public sector reached in 2003 the level of 5.7% of GDP, and the volume of public debt 51.6% of GDP. Data according to: the Convergence Programme – adopted by the Council of Ministers on 30 April 2004.

<sup>105</sup> Report on inflation in 2003, National Bank of Poland, Warsaw, March 2004.

profitability of 5 year Treasury bonds. The interest rate defined in that manner reached 5.6% in November 2003. Given the fact that interest rates in countries of the Euro zone were at a level of 4.2% (November 2003), Poland complies with that convergence criterion since March 2003.<sup>106</sup>

- **Foreign exchange rate:** Poland can become member of ERM II only from the moment of its accession to the European Union, as of 1 May 2004. Regardless the convergence of PLN and EUR exchange rates, to join the ECU a country must be member of ERM II for two years.
- From 12 April 2000, Poland applies the system of fluctuating exchange rate. In the Medium-Term Strategy for Monetary Policy in 1999–2003 it was assumed that this is the only effective manner to determine the balance rate. Knowledge of the balance rate will be necessary to define the parity of PLN towards EUR, under ERM II.
- In 2003, two cases of increased liquidity of PLN exchange rate have been observed. The first one occurred in the early 2003 and was caused by geographical and political conditions. The second one, in September 2003, was due to the uncertainty of financial markets regarding future fiscal policy of the state; and the declared significant increase of the state budget's lending needs. The last case could be treated as „serious tensions” by the European Commission and the European Central Bank.

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<sup>106</sup> „Report on the benefits and costs of Poland's accession to the Euro zone” – National Bank of Poland, Warsaw, February 2004.





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